SUPREME COURT, U. S.

NOV 29 1968

JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM - 1968

No. 783

D. C. TRANSIT SYSTEM, INC.,
Petitioner

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB and WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

SPEAR AND HILL
Harvey M. Spear
Leon G. R. Spoliansky
63 Wall Street
New York, New York 10005

HOGAN & HARTSON
Edmund L. Jones
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

Attorneys for Petitioner

Washington, D. C. · THIEL PRESS · 202 · 393-0625

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement of the Case	3
Reasons for Granting the Writ	9
Conclusion	26

TABLE OF AUTHORITIES

CASES:

American Toll Bridge Co. v. R. R. Comm'n of California, 307 U.S. 486 (1939) 19, 25

Austin v. Jackson, 353 F.2d 910 (4th Cir. 1965) 20

Bebchick v. Public Utilities Comm'n, 318 F.2d 187 (D.C. Cir. 1963), *cert. denied* 373 U.S. 913 (1963) 6

Communist Party of the United States v. Subversive Activities Control Board, 277 F.2d 78 (D.C. Cir. 1959), *aff'd* 367 U.S. 1 (1961) 21

County Board of Arlington County Va. v. United States, 101 F. Supp. 328 (D.C. Va. 1961) 12, 14, 15

Denver Union Stock Yard Co. v. United States, 304 U.S. 470 (1938) 25

D.C. Transit System Inc. v. Washington Metropolitan Area Transit Comm'n, 350 F.2d 753 (D.C. Cir. 1965) ..... *passim*

Eastern Central Motor Carriers Ass'n, Inc. v. United States, 251 F. Supp. 483 (D.C. Dist of Col. 1966) 21

Eastern Express Inc. v. United States, 198 F. Supp. 256 (Dist. Ct. Ind.), *aff'd* 369 U.S. 37 (1962) 16

Egan v. City of Aurora, 365 U.S. 514 (1961) 24

G. E. Employees Securities Corp. v. Manning, 42 F. Supp. 657 (D.C. N.J. 1941), *rev'd* 137 F.2d 637 (3d Cir. 1943) ... 15

Griffin v. People of the State of Illinois, 351 U.S. 12, *rehearing denied* 351 U.S. 958 (1956) 26

Page

Gustafson v. Fred Wolferman Inc., 73 F. Supp. 186 (D.C. Mo. 1947) 15

Increased Common Carrier Truck Rates in New England, 43 M.C.C. 13 (1943) 14

Increased Common Carrier Truck Rates in the East, 42 M.C.C. 633 (1943) 14

In Re Mercury Engineering Inc., 68 F. Supp. 376 (D.C. Cal. 1946) 15

King v. United States, 10 F. Supp. 206 (D.C. Md. 1935) *aff'd* 79 F.2d 453 (4th Cir. 1935) 15

Middle West General Increases, 48 M.C.C. 541 (1940) 14

Miller v. United States, 357 U.S. 301 (1958) 15

Mississippi River Fuel Corp. v. FPC, 163 F.2d 433, *rehearing denied* 163 F.2d 450 (D.C. Cir. 1947) 20

Re D. C. Transit System Inc., 33 P.U.R. 3d 137 (D.C. Pub. Util. Comm'n 1960) 10, 13

Re D. C. Transit System Inc., 38 P.U.R. 3d 19 (D.C. Pub. Util. Comm'n 1961) 10

Rochin v. California, 342 U.S. 165 (1952) 19, 26

SEC v. Chenery, 318 U.S. 80 (1943) 16, 20, 22

Thompson v. Louisville, 362 U.S. 199 (1960) 19, 26

Unemployment Compensation Comm'n of the Territory of Alaska v. Aragon, 329 U.S. 143 (1946) 15

Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951) 17

Universal Interpretive Shuttle Corp. v. Washington Metropolitan Area Transit Comm'n (U.S. Supreme Court, November 25, 1968) 23, 24

STATUTES AND LEGISLATIVE MATERIALS:

28 U.S.C. § 1254(1) 2

49 U.S.C. § 316(i) 14

Page

Transit's Congressional Franchise, Public Law 757, 70 Stat. 598 (1956)

Section 4 . . . . . 2, 3, 4, 8, 9, 10, 13, 23

Section 5 16

Washington Metropolitan Area Transit Regulation Compact, Public Law 86-794, 74 Stat. 1031 (1960); 1 D.C. Code § 1410 (1961 ed.) Title II, Article XII

Section 5(e) 4

Section 6(a)(3) 3, 14

Section 6(a)(4) 2, 3, 8, 9, 10, 13, 16, 23

Section 6(b) 19

Section 17(a) 5, 6, 7

H.R. Rep. No. 2034, 84th Cong., 2nd Sess. 3-8 (1956) 3

H.R. Conf. Rep. No. 2751, 84th Cong., 2nd Sess. 1-3 (1956) 4

S. Rep. No. 1791, 84th Cong., 2nd Sess. 10-13 (1956) 4

TEXT BOOKS AND ARTICLES:

Nichols and Welch, *Ruling Principles of Utility Regulation–Rate of Return* (1955) 12

Nichols and Welch, *Ruling Principles of Utility Regulation–Rate of Return Supplement A* (1964) 10

Wright, *Operating Ratio–A Regulatory Tool,* 51 Pub. Util. Fort. (1953) 10, 11, 14

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM - 1968

No.

D. C. TRANSIT SYSTEM, INC.,
Petitioner

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB and WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit ("Court of Appeals") entered in the above matter on October 8, 1968.

CITATIONS TO OPINIONS BELOW

The opinions of the Washington Metropolitan Area Transit Commission ("Commission"), printed at pages B-102 and B-121 of the Appendix are reported in 63 P.U.R. 3d 32 (1966) and 63 P.U.R. 3d 45 (1966). The *en banc* opinion of the Court of Appeals, dated October 8, 1968, is unreported as of the date of this petition and is printed at page B-1 of said Appendix.

JURISDICTION

The judgment of the Court of Appeals was entered on October 8, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals, in making its rates of return determinations without regard to and on bases other than the operating ratio method required by Section 4 of the Franchise and Section 6(a)(4) of the Compact, erred and erroneously decided an important statutory question in a manner which will affect the regulation of motor carriers throughout the United States.

2. Whether the Court of Appeals misconceived its function as a reviewing Court in substituting itself for the Commission in determining the precise amount of return which was just and reasonable, which determination process had been assigned and delegated to the Commission by the Congress and the legislatures of the States of Maryland and Virginia.

3. Whether the Court of Appeals violated fundamental principles of due process by depriving Transit of the return allowed Transit by the Commission without either first finding that the fares authorized by the Commission were unjust and unreasonable, or first giving the Commission the opportunity of making such findings as the Court of Appeals deemed necessary.

4. Whether the Court of Appeals, in determining that Transit was not entitled to rates of return on gross operating revenues of 4.87% and 6.03% in the 1963 and 1965 Rate Proceedings, respectively, rendered a decision which is contrary to and inconsistent with the interpretation by the Supreme Court of Section 6 of the Compact.

5. Whether the Court of Appeals deprived Transit of property without due process of law by allowing Transit a margin of return of only $1,107,000 and $1,550,000, in the 1963 and 1965 Rate Proceedings, respectively.

STATUTES INVOLVED

The statutory provisions involved are Section 4 of Transit's Congressional Franchise, and Sections 6(a)(3) and 6(a)(4) of the Compact. The provisions are printed at pages A-1 and A-2 of the Appendix filed herewith.

STATEMENT OF THE CASE

Petitioner, D.C. Transit System, Inc. ("Transit") is a corporation established under the laws of the District of Columbia on July 9, 1956 and is engaged in the mass transportation of passengers for hire within the District of Columbia and between certain points within the District of Columbia and the States of Maryland and Virginia ("Washington Metropolitan Area") pursuant to a Congressional Franchise, Public Law 84-757, 70 Stat. 598 (1956) ("Franchise").

Prior to the grant of the Franchise, due in large part to a 52 day strike by the bus drivers employed by Transit's predecessor, transit operations in the District of Columbia became so chaotic that the franchise of Transit's predecessor was revoked in July 1955 and the Public Utilities Commission of the District of Columbia was instructed to find a new private operator for the transit system in the District of Columbia. (H.R. Rep. No. 2034, 84th Cong., 2nd Sess. 3-8 (1956); JA p. 368).[1] Various plans were suggested to resolve the transit crisis in the District of Columbia, but it was not until the enactment of the Franchise that satisfactory conditions were agreed upon. Congress recognized that only if an opportunity to earn a reasonable return were assured would private enterprise be willing to provide the mass transportation system needed in the Washington Metropolitan Area. Congress also recognized that the method previously used to determine the reasonableness of the rate of return for motor carriers, *i.e.*, return on system

---

[1] "JA" refers to Joint Appendix which formed the record on appeal in the Court below and which is filed with this Court as part of the certified record.

rate base, was inadequate and outdated, and accordingly in the Franchise Congress specifically directed that the operating ratio method of rate determination be substituted for the system rate base method as soon as possible. (S. Rep. No. 1791, 84th Cong., 2nd Sess. 1-3 (1956); H.R. Conf. Rep. No. 2751, 84th Cong., 2nd Sess. 10-13 (1956)). Congress gave effect to its views in Section 4 of the Franchise as follows:

> "It is hereby declared as a matter of legislative policy that in order to assure the Washington Metropolitan Area of an adequate transportation system operating as a private enterprise, the Corporation, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the Corporation an attractive investment to private investors. As an incident thereto Congress finds that the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations . . . on either the system rate base or on gross operating revenues would not be unreasonable, and that the Commission should encourage and facilitate the shifting to such gross operating revenue base as promptly as possible and as conditions warrant; and if conditions warrant not later than August 15, 1958."

This case involves applications for authority to increase fares for the transportation of passengers within the District of Columbia, within the State of Maryland, and between the District of Columbia and points in Maryland filed by Transit on December 5, 1962 ("1963 Rate Proceedings") and September 17, 1965 ("1965 Rate Proceedings") with the Commission pursuant to Section 5 of the Franchise and Section 5(e) of Title II, Article XII of the Washington Metropolitan Area Transit Regulation Compact, Public Law 86-794, 74 Stat. 1031 (1960); 1 D.C. Code § 1410 (1961 ed.) ("Compact"),[2] (JA, Order No. 245, p. 1 and Order No. 563, p. 2).

---

[2] All citations to the Compact are to Article XII thereof.

1963 Rate Proceedings

On December 5, 1962, largely as a consequence of its increased labor costs, Transit filed an application for new fares with the Commission. During the course of the hearings held by the Commission in connection with the 1963 Rate Proceedings, Transit proposed that it be allowed a margin of return over and above operating expenses of $1,683,099, representing a rate of return on gross operating revenues of 5.16%, and in support of such proposal introduced considerable evidence sustaining the reasonableness of such return (JA, pp. 99-102; 355-365). However the Commission, in Order No. 245, denied the fares proposed by Transit, and instead authorized fares which would permit Transit a margin of return of only $1,480,746, representing a rate of return of 4.87% on gross operating revenues. (JA, Order No. 245, p. 41).

Thereafter, both Transit and respondents Richard A. Williams ("Williams") and Alfred S. Trask ("Trask") applied for reconsideration of Order No. 245 and, upon denial thereof, filed with the Court of Appeals petitions to review Order No. 245 pursuant to Section 17(a) of the Compact. (JA, p. 1).

On April 8, 1965 the Court of Appeals issued its opinion in *D. C. Transit System Inc. v. Washington Metropolitan Area Transit Comm'n*, 350 F.2d 753, 780 (D.C. Cir. 1965) ("*Transit I*") remanding certain portions of Order No. 245 to the Commission for further proceedings consistent with such opinion because the Commission had failed to provide the Court with an adequate basis for knowing what it did.

On January 26, 1966 the Commission, in response to the mandate of the Court of Appeals in *Transit I*, entered Order No. 563, supplementing Order No. 245, and reaffirmed its findings that a return of $1,480,746, representing a rate of return of 4.87% on Transit's gross operating revenues, was reasonable. (JA, p. 1).

On February 24, 1966 Williams and Trask filed an application for reconsideration of Order No. 563 which was denied by the Commission on March 25, 1966. (JA, pp. 14 and 20). On May 24, 1966 Williams and Trask filed a petition in the Court of Appeals for review of Order No. 563 pursuant to Section 17(a) of the Compact. (JA, p. 27). Thereafter, Transit moved to intervene in that proceeding, and such motion was granted on July 1, 1966. (JA, pp. 27 and 75).

1965 Rate Proceeding

On June 14, 1965 Transit entered into a labor contract with the union representing its employees which was to go into effect on November 1, 1965 for a term of one year. (JA, pp. 124 and 155). As a consequence of the new contract, Transit estimated the increases in wages, salaries and benefits to union and non-union employees for the calendar year 1966 would amount to $1,914,654. (JA, p. 117).

On September 17, 1965, largely due to its increased labor costs and also because Transit had earned a rate of return on gross operating revenues of only 3.23% for the year ended June 30, 1965 (JA, p. 110), Transit filed new tariffs with the Commission requesting authority to increase its fares. Transit proposed that it be allowed a margin of return over and above operating expenses of $2,144,361, representing a rate of return on gross operating revenues of 5.88%, and in support of such proposal introduced considerable evidence sustaining the reasonableness of such return. However, the Commission, in Order No. 564, denied Transit's application for an increase in fares (except for the Downtowner Minibus), finding that the amount of return to be realized by Transit together with a transfer of credits from a special reserve ordered by the Court of Appeals in *Bebchick v. Public Utilities Comm'n,* 318 F.2d 187 (D.C. Cir. 1963), *cert. denied,* 373 U.S. 913 (1963) would provide a margin of return which would be fair and reasonable.

On February 24, 1966 respondents Democratic Central Committee of the District of Columbia ("Central Committee"), Leonard N. Bebchick ("Bebchick") and Daniel W. Gottlieb ("Gottlieb") filed an application for reconsideration of Order No. 564 which was denied by the Commission on March 25, 1966. (JA, pp. 36 and 39). On May 24, 1966 the Central Committee, Bebchick and Gottlieb filed a petition with the Court of Appeals to review Order No. 564, pursuant to Section 17(a) of the Compact. (JA, p. 40). Thereafter, Transit moved to intervene in that proceeding, and said motion was granted on July 1, 1966. (JA, pp. 45 and 75).

On March 1, 1966 Transit filed an application for reconsideration of Order No. 564, claiming that the Commission had failed to grant Transit sufficient increases in fares to cover the margin of return that the Commission found to be fair and reasonable. Essentially it was Transit's position that the disallowance of certain items by the Commission would result in Transit's earning approximately $826,000 less than the amount projected by the Commission. Said application was denied by the Commission on March 25, 1966, and on May 24, 1966 Transit filed a petition with the Court of Appeals for the review of Order No. 564 pursuant to Section 17(a) of the Compact. (JA, p. 63).[3]

On July 1, 1966 an order was entered in the Court of Appeals consolidating the foregoing appeals. (JA, p. 75).

---

[3]Transit's appeal from Order No. 564 was Case No. 20,202 below. Transit alleged therein that the Commission erroneously disallowed $252,688 as an operating expense for unreimbursed depreciation on a garage and office building while they had been devoted to public use, and $574,578 in bus maintenance costs. (JA, p. 283; Order No. 564, p. 15). Since the Court of Appeals found for Transit on these items and remanded Case No. 20,202 to the Commission for further consideration, Transit does not seek review of the Court of Appeals decision to the extent it applies to Case No. 20,202.

Opinion of the Court of Appeals

The Court of Appeals rejected the margin of return of $1,480,746, representing a rate of return of 4.87% on gross operating revenues, found by the Commission in Order No. 563 (relating to the 1963 Rate Proceedings) to be reasonable. (A, pp. B-9, B-24 and B-25.)[4] It likewise rejected the margin of return of $2,000,000, representing a return on gross operating revenues of 6.03%, found by the Commission in Order No. 564 (relating to the 1965 Rate Proceedings) to be fair and reasonable. (A, p. B-82).

After expressly stating that it did *not* hold that the fares authorized by the Commission in the 1963 and 1965 Rate Proceedings were "unjust or unreasonable as a matter of law," the Court of Appeals nevertheless proceeded to reject the findings of the Commission and substitute therefor the proposals advanced by the respondents. (A, pp. B-34 and B-35.)[5] This was done without any finding by the Court of Appeals that the return proposed by respondents was just and reasonable. (A, pp. B-40 and B-41.) In addition to the egregious error of substituting its findings for those of the Commission, the Court compounded the error by failing to apply the operating ratio method of rate determination required to be applied by Section 4 of the Franchise and Section 6(a)(4) of the Compact.

---

[4] "A" refers to the Appendix filed concurrently with the petition for a writ of certiorari, as required by Rule 23 of this Court.

[5] Unless otherwise indicated, the term "respondents" includes all respondents herein except the Commission.

REASONS FOR GRANTING THE WRIT

I

The Decision of the Court of Appeals Involves an Important Question of Statutory Interpretation Which Affects the Regulation of Motor Carriers Within the District of Columbia, the States of Maryland and Virginia, and Throughout the United States.

A. The Decision of the Court Below Is in Conflict with the Laws Governing the Regulation of Motor Carriers in the District of Columbia and the States of Maryland and Virginia in that It Fails To Apply the Required Operating Ratio Method of Rate Making.

1. *The Franchise and the Compact require that the operating ratio method of rate making be used by the Commission.*

Section 4 of the Franchise provides as follows:

> "As an incident [to the opportunity of earning such return as to make the Corporation an attractive investment to private investors] the Congress finds that the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on either the system rate base or on *gross operating revenues* would not be unreasonable, and that the Commission should encourage and facilitate the *shifting to such gross operating revenue* base as promptly as possible and as conditions warrant; and if conditions warrant not later than August 15, 1958." (Emphasis supplied.)

Section 6(a)(4) of the Compact states:

> "[T]he opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on *gross operating revenues*, shall not be considered unreasonable." (Emphasis supplied.)

Section 6(a)(4) of the Compact was intended to reaffirm and reenact Section 4 of the Franchise. *Transit I*, at p. 764.

The reason that Section 6(a)(4) of the Compact omits any reference to a return on "system rate base" is that the Commission's predecessor, the Public Utilities Commission, had adopted the "modern rate-making standard," the operating ratio method, prior to the enactment of the Compact. *Transit I*, at p. 764. See also *Re D. C. Transit System Inc.*, 33 P.U.R. 3d 137 (D.C. Pub. Util. Comm'n 1960); *Re D. C. Transit System Inc.*, 38 P.U.R. 3d 19 (D.C. Pub. Util. Comm'n 1961). The adoption of the operating ratio method by the Public Utilities Commission was the result of the specific directive of Congress in Section 4 of the Franchise which required that:

> "the Commission should encourage and facilitate the shifting to such gross operating revenue base as promptly as possible and as conditions warrant; and if conditions warrant not later than August 15, 1958."

The adoption of the operating ratio method by the Public Utilities Commission constituted the "shifting" to the operating ratio method called for by Section 4 of the Franchise.

Clearly, therefore, both the Franchise and the Compact *require* that the operating ratio method of rate making be utilized by the Commission in determining Transit's rate of return.

2. *Why it was necessary for Congress to require the Commission to use the operating ratio method of rate making.*[6]

The need for the departure from the traditional test of return on investment, as used in the typical non-transit util-

---

[6]The operating ratio of a transit company is the ratio of its operating expenses to its total operating revenue; or its operating expenses divided by its operating revenue. Nichols and Welch, *Ruling Principles of Utility Regulation–Rate of Return Supplement A*, p. 338 (1964). See also Wright, *Operating Ratio–A Regulatory Tool*, 51 Pub. Util. Fort., pp. 24-29 (1953). The amount earned over and above the operating expenses, expressed as a percentage of operating revenues, is called the return on gross operating revenues. *Transit I*,

ity, was recognized because of the volatile nature of the operations, especially the expenses, of a transit company. Wright, *Operating Ratio - A Regulatory Tool,* 51 Pub. Util. Fort. pp. 24-25 (1953) ("Wright"); *County Board of Arlington County Va. v. United States,* 101 F. Supp. 328 (D.C. Va. 1951). Thus, *e.g.,* whereas a return of 6% on the capital invested in a non-transit public utility may provide a reasonable return to such company because of the typically large capital investment, it may well be inadequate for a transit company. This is illustrated at p. 24 of Wright as follows:

	Nontransit Utility	Transit Company
Net Plant Investment	$25,000,000	$ 4,000,000
Annual Revenue	10,000,000	10,000,000
Operating Expenses	8,500,000	9,760,000
Return to Investors	1,500,000	240,000

In the illustration both the transit company and the nontransit utility have the same annual revenue and a return of 6% on each of their investments. Yet, if the patronage of the transit company declines, or the expenses increase 2½%, it will be operating at a loss. The nontransit company, however, which typically has no substantial fluctuation in revenues or expenses, can experience a 2½% change and still give its investors a 5% return on their investment.

The importance of the utilization of the operating ratio method of rate making for transit companies and other motor carriers is perhaps best illustrated by the fact that, although not required, such standard has been adopted by the Interstate Commerce Commission ("ICC") and at least

---

at p. 760. Thus if a transit company had operating revenues of $100,000 and operating expenses of $95,000, its operating ratio would be 95% and its return on gross operating revenues would be 5%.

ten state regulatory agencies. *County Board of Arlington County Va. v. United States, supra,* at p. 330; Wright. pp. 24-25.

3. *The Court of Appeals did not apply the operating ratio method of rate making*

In reviewing the Commission's determination of what constituted a reasonable rate of return for Transit, the Court of Appeals failed to utilize the operating ratio method of rate making, which method was prescribed by the Franchise and the Compact. Instead of using the operating ratio method, the Court of Appeals reviewed the Commission's determination on the basis of a different standard chosen by the Court and not by Congress. The standard applied by the Court of Appeals is generally termed the cost-of-capital approach to rate making, *i.e.*, a consideration limited to the interest and dividend costs of a company. Nichols and Welch, *Ruling Principles of Utility Regulation - Rate of Return,* pp. 195-199 (1955).

The Court of Appeals concluded that, from the Commission's orders, the Court of Appeals was unable to determine how the Commission found that returns of 4.87% and 6.03%, as computed under the operating ratio method, were just and reasonable. In so concluding, the Court of Appeals ignored the Commission's careful and detailed analysis of Transit's operating revenues and expense requirements, which the Commission had made pursuant to its understanding of *Transit I.* (A, pp. B-105 to 119; B-141 to B-156). After disregarding the Commission's analysis, the Court of Appeals went on to evaluate the evidence on certain subjects it thought important and to ignore the evidence which the Commission (and Transit) thought important. In its opinion, the Court of Appeals looked solely to and based all of its reasoning upon the testimony and evidence concerning the cost of debt and equity capital and it ignored the very considerations which the Court of Appeals had itself spelled out in *Transit I* at p. 779, namely:

> ". . . the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2."

See also *Re D. C. Transit System Inc.*, 33 P.U.R. 3d 137, 170 (D.C. Pub. Util. Comm'n 1960).

As a result of the application by the Court of Appeals of an erroneous standard of rate making, Transit's margin of return in the 1963 Rate Proceeding was reduced by the Court of Appeals by the amount of $373,746 and its margin of return in the 1965 Rate Proceeding was reduced by the Court of Appeals by the amount of $450,000. (A, pp. B-2, B-37, B-82 and B-97). Furthermore, Transit's rate of return on gross operating revenues was accordingly reduced by the Court of Appeals in the 1963 Rate Proceeding from 4.87% to 3.64% and in the 1965 Rate Proceeding from 6.03% to 4.64%. The rates of return provided by the Court of Appeals are inadequate and do not allow sufficient funds to provide a surplus which would satisfy the standards enumerated by the Court of Appeals in *Transit I*, pp. 778 and 779.

The Court of Appeals erred in failing to use the operating ratio method of rate making as required by the applicable statutes, Section 4 of the Franchise and Section 6(a)(4) of the Compact, and accordingly Transit's petition for a writ of certiorari should be granted.

B. The Court of Appeals Erroneously Decided a Question of Importance in the Regulation and Administration of Motor Carriers Throughout the United States.

1. *The operating ratio method of rate making is used by the ICC in regulating motor carriers subject to the Motor Carrier Act.*

In carrying cut its statutory obligation to set reasonable fares for motor carriers, pursuant to Part II of the Interstate Commerce Act, 49 U.S.C. § 316(i) (the "Motor Carrier Act"), which is identical to the pertinent provisions of Section 6(a)(3) of the Compact, the ICC has adopted the operating ratio method of rate making. *County Board of Arlington County Va. v. United States, supra; Increased Common Carrier Truck Rates in New England,* 43 M.C.C. 13 (1943); *Increased Common Carrier Truck Rates in the East,* 42 M.C.C. 633 (1943); *Middle West General Increases,* 48 M.C.C. 541 (1940). The predominance of the operating ratio method in the determinations by the ICC of a reasonable return is not a matter of choice, but is dictated by the nature of the motor carrier industry.[7] *County Board of Arlington County Va. v. United States, supra,* at p. 330.

Moreover, at least ten state regulatory agencies, with statutory language similar to the Motor Carrier Act, have followed the lead of the ICC and adopted the operating ratio method of rate making. Wright, p. 25 and cases cited.

2. *Importance of the decision of the Court of Appeals in the regulation and administration of motor carriers.*

The ICC has adopted the operating ratio method of rate making as being the method dictated by the nature of the motor carrier industry, *County Board of Arlington County Va. v. United States, supra,* at p. 330, and accordingly the decision of the Court of Appeals affects the regulation and

---

[7] This is so even though there is no specific statutory requirement in the Motor Carrier Act, as opposed to the Franchise and Compact, that the operating ratio method be used.

administration of motor carriers throughout the United States.

The decision of the Court of Appeals, disregarding the statute-mandated operating ratio method of rate making and holding that the cost-of-capital method is the appropriate method for prescribing rates of return for motor carriers represents the only decision by a United States Court of Appeals, which Transit has been able to find, on the appropriate standard for determining the rate of return to be allowed to a motor carrier in cases where the operating ratio method is prescribed. Being the highest federal court which has passed upon the subject, its decision will be given great weight by the district courts throughout the United States charged with reviewing the reasonableness of rates prescribed by the ICC,[8] and may in fact be binding on the district courts in certain circuits.[9]

In any event, the administration of the Motor Carrier Act by the ICC will be disrupted because the ICC is faced with conflicting decisions as to the extent to which the operating ratio method of rate making must be qualified and modified by the cost-of-capital method of rate making. Cf. *County Board of Arlington County Va. v. United States, supra,* and the instant decision of the Court of Appeals.

Transit submits that the erroneous decision of the Court of Appeals on the method to be used to determine the rate of return to be allowed motor carriers, affecting as it does such a wide area of public interest, is a further basis for the Supreme Court to grant Transit's petition for certiorari in order that this important issue may be finally settled. See *Miller v. United States,* 357 U.S. 301 (1958); *Unemployment Compensation Comm'n of the Territory of Alaska v. Aragon,* 329 U.S. 143 (1946).

---

[8] *G. E. Employees Securities Corp. v. Manning,* 42 F. Supp. 657 (D.C. N.J. 1941), *rev'd on other grounds,* 137 F.2d 637 (3d Cir. 1943); *King v. United States,* 10 F.Supp. 206 (D.C. Md. 1935) *aff'd* 79 F.2d 453 (4th Cir. 1935).

[9] *In re Mercury Engineering Inc.,* 68 F.Supp. 376 (D.C. Col. 1946); *Gustafson v. Fred Wolferman Inc.,* 73 F. Supp. 186 (D.C. Mo. 1947).

II

The Court of Appeals Misconceived Its Function as a Reviewing Court in Substituting Itself for the Commission in Determining the Precise Amount of Return Which Was Just and Reasonable, Which Determination Process Had Been Assigned and Delegated to the Commission by the Congress and the Legislatures of the States of Maryland and Virginia.

The determination of what constitutes a reasonable rate of return for Transit is a matter which the Congress, the District of Columbia and the States of Maryland and Virginia specifically entrusted to the Commission. Franchise, § 5; Compact, § 6, *supra*. In addition, the courts have repeatedly held that such a function is solely within the discretion of an administrative agency. *Eastern Express Inc. v. United States*, 198 F. Supp. 256, 260 (D.C. Ind. 1961), *aff'd* 369 U.S. 37 (1962). An exercise of judgment by the Commission in an area assigned and delegated to it by Congress, the legislatures of two states and the District of Columbia cannot be set aside because the reviewing court might have made a different interpretation were it required to do so. *SEC v. Chenery*, 318 U.S. 80, 94 (1943).

Transit submits that the Court of Appeals substituted itself for the Commission in an area assigned and delegated to the expertise of the Commission. The Franchise and the Compact state that the Commission shall determine whether fares are just and reasonable and shall employ the operating ratio method of rate making in doing so. This the Commission did in accordance with the standards enunciated by the Court of Appeals in *Transit I*.

The operating ratio method, being the standard used by the Commission in determining the reasonableness of the rates allowed to Transit, is the only standard by which the reviewing court can judge whether the Commission was right or wrong. *SEC v. Chenery, supra*, at p. 87. However, the Court of Appeals disregarded the operating ratio meth-

od of rate making and used its own standard, the cost of debt and equity capital to Transit, and thereafter independently determined the rate of return to which it felt Transit was entitled. Although the Court failed to find that there was no substantial evidence to support the findings and conclusions of the Commission, the Court of Appeals substituted the proposal of the respondents for the findings and conclusions of the Commission. (A, pp. B-34, B-35, B-40 and B-41).

The action of the Court of Appeals is unprecedented. Its function is to determine whether there is substantial evidence and a rational basis for the action taken by the Commission. *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951). Rather than limiting itself to this consideration, the Court here proceeded to determine whether there was a substantial foundation *not for the result arrived at by the Commission under the standard required to be applied by the Commission,* but rather for a new and different standard which the Court of Appeals determined it would apply on appeal.

Simply by applying a standard other than that required to be applied by the administrative agency and then determining that there is insufficient evidence under this new standard, reviewing courts could easily reverse the judgment of the "experts." The findings of fact of expert administrative tribunals should not be set aside if supported by substantial evidence. *Universal Camera Corp. v. NLRB, supra.* If the procedure followed in this case by the Court of Appeals is allowed to stand, the entire rationale for the creation of administrative tribunals vested with expertise and for giving their expert decisions the presumption of validity, if based on substantial evidence, will be thwarted. Accordingly, Transit's petition for a writ of certiorari should be granted.

III

The Court of Appeals Violated Fundamental Principles of Due Process by Depriving Transit of the Return Allowed by the Commission Without Either First Finding That the Fares Authorized by the Commission Were Unjust or Unreasonable or First Giving the Commission the Opportunity of Making Such Findings as the Court of Appeals Deemed Necessary.

A. The Court of Appeals Did Not Find the Rates of Return Allowed by the Commission To Be Unjust or Unreasonable.

The Court of Appeals stated in its opinion as follows:

> "In this case, given our conclusion that the Commission failed to apply appropriate criteria, and failed to make the inquiries prerequisite to valid exercise of its rate-setting authority, we could not permit Transit to retain the increased fares, since to do so would be to give legal effect to the Commission's invalid order. *This is so notwithstanding that we have held neither that the Commission lacked power to order a fare increase, nor even that the fares authorized are, as a matter of law, unjust or unreasonable.*" (A, pp. B-33 to B-35; Emphasis supplied).

In other words, because the Court of Appeals found that the Commission failed to apply the new criteria the Court deemed appropriate in establishing fares for Transit, the Court reduced Transit's revenues although the fares authorized and the rates of return allowed were not found to be "unjust or unreasonable." By reducing Transit's revenues the Court of Appeals in effect prescribed what it deemed to be the lawful fares to which it believed Transit was entitled. Transit submits that such a determination violates the fundamental principles of fairness found necessary by the Supreme Court to satisfy the demands of due process of law in that it deprives Transit of property without a find-

ing that Transit was not entitled thereto. *Thompson v. Louisville,* 362 U.S. 199 (1960); *Rochin v. California,* 342 U.S 165 (1952); *American Toll Bridge Co. v. R.R. Comm'n of California,* 307 U.S. 486 (1939).

Moreover, the Court of Appeals assumed unto itself broader regulatory powers than those which were delegated to the Commission by Congress and the legislatures of Maryland and Virginia. Section 6(b) of the Compact provides that fares charged by a carrier may not be changed (absent a request for such change by the carrier) without a hearing and a finding that such fares are unjust or unreasonable. Section 6(b) states as follows:

> "Whenever, upon complaint, or upon its own initiative, and after hearing held upon reasonable notice, the Commission finds that any individual or joint fare in effect for transportation subject to this Act . . . is unjust, unreasonable or unduly preferential or unduly discriminatory, the Commission shall issue an order prescribing the lawful fare, regulation, or practice thereafter to be in effect."

The Court of Appeals, in effect, set aside the fares authorized by the Commission in the 1963 and the 1965 Rate Proceedings without finding that the fares authorized by the Commission were unjust or unreasonable. In this too, the Court of Appeals has violated the fundamental principles of fairness found necessary by the Supreme Court to satisfy the demands of due process of law by depriving Transit of property without a finding that Transit was not entitled thereto. *Thompson v. Louisville, supra; Rochin v. California, supra; American Toll Bridge Co. v. R.R. Comm'n of California, supra.*

B. If the Orders of the Commission Were Not Supported by a Rational Basis the Court of Appeals Was Bound To Remand the Case to the Commission.

As heretofore stated, Transit believes that the Commission did give a rational basis for its conclusions which were based

on the operating ratio method of rate making, whereas the Court of Appeals based its determination on an unauthorized and erroneous standard of cost-of-capital rate making.

Assuming, *arguendo*, that the Commission had failed to provide the rational basis for its decision which the law requires, the proper procedure is to remand the case for further proceedings by the Commission. *SEC v. Chenery, supra; Austin v. Jackson*, 353 F.2d 910 (4th Cir. 1965); *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433, *rehearing denied* 163 F.2d 450 (D.C. Cir. 1947). Thus in the *Chenery* case, *supra*, the Supreme Court, in remanding the case to the Securities and Exchange Commission, stated at p. 88:

> "If an order is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service for an administrative judgment. For purposes of affirming no less than reversing its orders, an appellate court cannot intrude upon the domain which Congress has exclusively entrusted to an administrative agency."

Similarly in *Austin v. Jackson, supra*, at p. 912, the Court, after stating it could not find a rational basis for the agency's decision, stated:

> "As in the case where administrative action cannot be upheld on the reasons the agency has assigned, the court will not state proper reasons and uphold but will remand the case to the agency."

The fact that the Court of Appeals had already remanded the case to the Commission once is no excuse for not following the aforementioned principle. In *Transit I*, the Court of Appeals remanded the proceeding to the Commission for findings concerning:

> ". . . the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his

> money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2." *Transit I* at p. 779.

Upon remand, the Commission made findings on the above-decided matters called for by *Transit I.* But, in reviewing the remand decision, the Court of Appeals decided that the Commission should have made findings concerning the cost of capital to Transit, an issue which had not theretofore been specifically remanded to the Commission. Rather than setting aside the Commission order, it is clear that the proper procedure for the Court of Appeals to have followed would have been to remand the case once again to the Commission to make the further findings which the Court of Appeals deemed to be necessary. *Communist Party of the United States v. Subversive Activities Control Board,* 277 F.2d 78 (D.C. Cir. 1959), *aff'd* 367 U.S. 1 (1961).

Moreover, even in cases where a court has remanded a case because the agency failed to provide a rational basis for its decision and the court, in reviewing the agency findings upon remand, determines that the agency has not followed the reviewing court's mandate, the proper procedure is to remand the case once again. *Cf. Eastern Central Motor Carriers Ass'n v. United States,* 251 F. Supp. 483 (D.C. Col. 1966).

Accordingly, even if the Court of Appeals were correct in finding that there was no rational basis expressed in the Commission's decision, something which Transit does not concede, the proper procedure was to remand the case to the Commission, not—as the Court did—take upon itself the functions specifically vested in the Commission.

C. The Issue Before the Commission Upon Remand Would Be Whether the Fares Prescribed by the Commission Would Result in Transit Receiving an Unreasonable Rate of Return.

The reason given by the Court of Appeals for not remanding the case to the Commission to determine whether the rate of return allowed Transit was reasonable was that any such determination by the Commission would involve an unauthorized retroactive establishment of rates. (A, pp. B-29 to B-31). The reasoning is completely fallacious. The issue before the Commission on remand would be whether or not the rates of return allowed Transit during the 1963 and 1965 Rate Proceedings were reasonable. If the Commission finds that the rates of return were reasonable and supports such finding with a reasoned decision, its determination must be upheld. *SEC v. Chenery, supra.*

Even if the Commission should decide that Transit is entitled to rates of return other than those originally found by the Commission to be reasonable in the 1963 and 1965 Rate Proceedings, this would not result in retroactively fixing fares but would merely adjust the rate of return to be allowed Transit in the relevant period of time in the same manner as was accomplished by the Court of Appeals. It is for the Commission, not the Court of Appeals, to determine what rates of return are just and reasonable. *SEC v. Chenery, supra.*

Transit submits that the decision of the Court of Appeals violates fundamental principles of due process in that it reduces the rates of return allowed to Transit by the Commission without a finding that such rates are unreasonable. Accordingly, Transit's petition for a writ of certiorari should be granted.

IV

The Determination by the Court of Appeals That Transit Was Not Entitled to Rates of Return on Gross Operating Revenues of 4.87% and 6.03% in the 1963 and 1965 Rate Proceedings, Respectively, Is Contrary to and Inconsistent With the Interpretation by the Supreme Court of Section 6 of the Compact.

Section 4 of the Franchise provides in pertinent part that:

> " . . . a return of at least 6½ per centum . . . on gross operating revenues . . . would not be unreasonable. . . ."

for Transit. Congress reaffirmed Section 4 of the Franchise in the adoption of Section 6(a)(4) of the Compact (*Transit I*, at p. 764) which provides in pertinent part that:

> " . . . the opportunity to earn a return of at least 6½ per centum . . . on gross operating revenues, shall not be considered unreasonable."

In *Universal Interpretive Shuttle Corp. v. Washington Metropolitan Area Transit Comm'n,*[10] the Supreme Court, in interpreting the Compact to determine the scope of the powers of the Commission, found that under Section 6 of the Compact, the Commission " . . . could set whatever fare it found reasonable, *although a profit of 6½% could not be prohibited.*" (Emphasis supplied).

If a "profit of 6½%" cannot be "prohibited," *a fortiorari*, a rate of return which will allow a lesser profit cannot be "prohibited" or set aside as being too high. It is clear from both the Franchise and the Compact, as interpreted by the Supreme Court, that if, as in the instant case, the Commission makes determinations that the anticipated rates of return on gross operating revenues, for the periods

---

[10]Page 4 of the slip opinion of the United States Supreme Court, decided by the Supreme Court on November 25, 1968, subsequent to the decision and judgment by the Court of Appeals of October 8, 1968 appealed from herein.

at issue, will be less than 6½%, and if the calculations as to the operating expenses and gross operating revenues used in making such determinations are supported by substantial evidence, the Commission orders allowing Transit rates of return of not more than 6½% on gross operating revenues may not be "prohibited" or set aside.

The Court of Appeals set aside the conclusions of the Commission that Transit was entitled to rates of return of 4.87% and 6.03% in the 1963 and 1965 Rate Proceedings, respectively, on the ground that the Commission failed to give a "rational basis" therefor.

The Court of Appeals did not find that the Commission's calculations of Transit's anticipated operating expenses and revenues were not supported by substantial evidence.

The "rational basis" for rates of return of 4.87% and 6.03% is the statutory mandate from Congress and the legislatures of Maryland and Virginia that rates of return of "at least 6½%" are "not unreasonable," and hence "not prohibited." *Id.*

The decision of the Court of Appeals that Transit was not entitled to rates of return on gross operating revenues of 4.87% and 6.03% is contrary to and inconsistent with the decision of the Supreme Court in *Universal Interpretive Shuttle Corp. v. Washington Metropolitan Area Transit Comm'n, supra.* Accordingly, Transit's petition for certiorari should be granted. *Egan v. City of Aurora,* 360 U.S. 514 (1961).

V.

The Court of Appeals Erred in Determining that Transit Should Be Allowed a Return of Only $1,107,000 and $1,550,000 in the 1963 and 1965 Rate Proceedings, Respectively, in that Such Returns Are Confiscatory and Deprive Transit of Property Without Due Process of Law.

The due process clauses of the 5th and 14th Amendments require that Transit be allowed a fair rate of return on the property it devotes to the public interest. U.S. Const. Amends. V and XIV, § 1; *American Toll Bridge Co. v. R.R. Comm'n of California*, 307 U.S. 486 (1939); *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470 (1938). The Commission found that a margin of return for Transit of $1,480,746 in the 1963 Rate Proceeding and $2,000,000 in the 1965 Rate Proceeding were fair and reasonable. (A, pp. B-11 and B-89). Transit submits that the record shows that any lesser margins of return would be confiscatory and a deprivation of property without due process of law because the margins allowed by the Commission were considered to be the minimum permissible in light of the risks of Transit's operations and the return allowed regulated utilities with similar risks. (A, pp. B-115 and B-156). Accordingly, the margins of return of $1,107,000 and $1,550,000 allowed by the Court of Appeals in the 1963 and 1965 Rate Proceedings, respectively, are unreasonably low and deprive Transit of property without due process of law.

Moreover, the Court of Appeals accepted the margins of return of $1,107,000 and $1,550,000 advanced by respondents in the 1963 and 1965 Rate Proceedings although there was no consideration by the Court of the reasonableness of the operating revenues and expenses which would be allowed to Transit under respondents' proposals, as well as the other criteria required by *Transit I* to be analyzed in establishing a reasonable rate of return based on gross op-

erating revenues. Although due process may not include the assurance of the right of appeal, when an appeal is granted the proceedings on appeal must accord with common standards of due process. *Griffin v. People of State of Illinois,* 351 U.S. 12, *rehearing denied* 351 U.S. 958 (1956). Transit submits that the allowance of a rate of return by the Court of Appeals without considering the criteria established by it in *Transit I,* on which the Commission and Transit relied, and without affording Transit the opportunity to be heard on the new criteria established by the Court, violates the standards of fundamental fairness necessary to satisfy the demands of due process of law. *Thompson v. Louisville,* 362 U.S. 199 (1960); *Rochin v. California,* 342 U.S. 165 (1952).

CONCLUSION

What the Court of Appeals has done in this case warrants the exercise of the Supreme Court's jurisdiction. Rather than sitting as a reviewing body and determining—under the applicable statutes—whether the Commission's action was supported by an adequate basis, the Court has cast itself as an administrative agency. It has failed to review the Commission's decision in the light of the legislative standard required to be applied by the Commission. Instead, it has substituted its own determinations of what standard the Commission should have applied and then proceeded to usurp the function of the Commission and determine on the basis of this erroneous standard what a reasonable rate of return for Transit should be. It is well established that a reviewing tribunal cannot substitute its findings for those of the authorized administrative agency. Yet that is precisely what has happened in this case. The Court substituted its findings for those of the Commission and its standard for that prescribed by the Congress and the legislatures of Maryland and Virginia.

Moreover, the conflict created by the Court of Appeals as to the standards to be applied in determining the rates of return to be allowed to motor carriers must be resolved by the Supreme Court. In emasculating the operating ratio method of rate making by qualifying and modifying it by the outdated standards of the system rate base and cost-of-capital methods, the Court of Appeals has disrupted and distorted the operating ratio rate making procedure for motor carriers which are applied by the ICC throughout the United States and in ten states as well as in the Washington Metropolitan Area.

For all of the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

SPEAR AND HILL
Harvey M. Spear
Leon G. R. Spoliansky
63 Wall Street
New York, New York 10005

HOGAN & HARTSON
Edmund L. Jones
815 Connecticut Ave., N.W.
Washington, D.C. 20006

Attorneys for Petitioner

SUPREME COURT, U. S.

NOV 29 1968

JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM - 1968

No. 783

D. C. TRANSIT SYSTEM, INC.,
Petitioner

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB and WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondents

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

SPEAR AND HILL
Harvey M. Spear
Leon G. R. Spoliansky
63 Wall Street
New York, New York 10005

HOGAN & HARTSON
Edmund L. Jones
815 Connecticut Avenue, N.W.
Washington, D.C. 20006

Attorneys for Petitioner

Washington, D. C. · THIEL PRESS · 202 · 393-0825

INDEX

Page

APPENDIX A - Statutes Involved

Transit's Congressional Franchise, Public Law 84-757, 70 Stat. 590 (1956), Section 4 ..... A-1

Washington Metropolitan Area Transit Regulation Compact, Public Law 86-794, 74 Stat. 1031 (1960), 1 D.C. Code § 1410 (1961 ed.), Title II, Article XII,
Section 6(a)(3) A-2
Section 6(a)(4) A-2

APPENDIX B - Opinions of Courts Below

Opinion of Court of Appeals for the District of Columbia Circuit B-1

Order No. 563 of the Washington Metropolitan Area Transit Commission B-102

Order No. 564 of the Washington Metropolitan Area Transit Commission B-121

APPENDIX A
STATUTES INVOLVED

I

Section 4 of Transit's Congressional Franchise, Public Law 84-757, 70 Stat. 598 (1956)

Sec. 4. It is hereby declared as a matter of legislative policy that in order to assure the Washington Metropolitan Area of an adequate transportation system operating as a private enterprise, the Corporation, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the Corporation an attractive investment to private investors. As an incident thereto the Congress finds that the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on either the system rate base or on gross operating revenues would not be unreasonable, and that the Commission should encourage and facilitate the shifting to such gross operating revenue base as promptly as possible and as conditions warrant; and if conditions warrant not later than August 15, 1958. It is further declared as a matter of legislative policy that if the Corporation does provide the Washington Metropolitan Area with a good public transportation system, with reasonable rates, the Congress will maintain a continuing interest in the welfare of the Corporation and its investors.

II

Section 6(a)(3) of Article XII, Title II
of the Washington Metropolitan Area
Transit Regulation Compact,
Public Law 86-794,
74 Stat. 1031 (1960)

6. (a) (3) In the exercise of its power to prescribe just and reasonable fares and regulations and practices relating thereto, the Commission shall give due consideration, among other factors, to the inherent advantages of transportation by such carriers; to the effect of rates upon the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable such carriers, under honest, economical, and efficient management, to provide such service.

III

Section 6(a)(4) of Article XII, Title II
of the Washington Metropolitan Area
Transit Regulation Compact,
Public Law 86-794,
74 Stat. 1031 (1960)

6. (a) (4) It is hereby declared as a matter of legislative policy that in order to assure the Washington Metropolitan District of an adequate transportation system operating as private enterprises the carriers therein, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As an incident thereto, the opportunity to earn a return of at least 6½ per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

APPENDIX B

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 20,200

RICHARD A. WILLIAMS and ALFRED S. TRASK,
Petitioners

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondent

D.C. TRANSIT SYSTEM, INC., Intervenor

No. 20,201

DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA,
LEONARD N. BEBCHICK and DANIEL W. GOTTLIEB, Petitioners

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondent

D.C. TRANSIT SYSTEM, INC., Intervenor

No. 20,202

D.C. TRANSIT SYSTEM, INC., Petitioner

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,
Respondent

On Petitions to Review Orders of the
Washington Metropolitan Area Transit Commission

Decided October 8, 1968

Mr. Leonard N. Bebchick, with whom *Mr. Stanley O. Sher* was on the brief, for petitioners in Nos. 20,200 and 20,201.

Mr. Harvey M. Spear, with whom *Mr. Edmund L. Jones* was on the brief, for petitioner in No. 20,202 and intervenor in Nos. 20,202 and 20,201.

Mr. Russell W. Cunningham for respondent.

Before BAZELON, *Chief Judge*, FAHY*, DANAHER, BURGER, WRIGHT, McGOWAN, TAMM and ROBINSON, *Circuit Judges*, sitting *en banc*.

ROBINSON, *Circuit Judge:* In *D.C. Transit System, Inc.* v. *Washington Metropolitan Area Transit Commission (Transit I)*,[1] we reviewed the Commission's Order No. 245,[2] promulgated after a public hearing in 1963, by which Transit was authorized to raise its token fare for passenger transportation within the District of Columbia and between the District and points in Maryland.[3] We then resolved several subsidiary issues germinated by that order, but were unable to pass judgment as to the legal propriety of the fare increase. The order in that aspect was predicated upon the Commission's finding that a margin of return of $1,480,746, representing a 4.87% rate of return on Transit's operating revenues, was just and reasonable.[4] Upon examination of the record,

---

*Circuit Judge Fahy became *Senior Circuit Judge* April 13, 1967.

[1] 121 U.S.App.D.C. 375, 350 F.2d 753 (*en banc* 1965).

[2] *In re D. C. Transit Sys., Inc.* (Order No. 245), 48 P.U.R.3d 385 (1963).

[3] Transit sought to raise to 25 cents the price of tokens then being sold for 20 cents in units of five for $1.00. Order No. 245 permitted Transit to increase the token fare to 21.25 cents, tokens to be sold in units of four for 85 cents. The order left unaffected the adult cash fare at 25 cents, as to which no change was requested.

[4] *In re D. C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 411-13. The Commission utilizes the operating ratio

however, we discovered that we had "no intelligible basis for disposing of the competing claims before us that the return allowed by the Commission is, on the one hand, too high, and, on the other, too low."[5] Accordingly, we remanded the case to the Commission "for further proceedings . . . to determine the margin of return over and above operating expenses that Transit should be allowed."[6]

On September 17, 1965, shortly before our remanding order was certified to the Commission, Transit filed a new tariff making numerous fare changes for 1966,[7] including elevations in the District cash fare from 25 to 30 cents, and in the District token fare from 21.25 to 25 cents.[8] Exerting a power conferred by the Washington Metropolitan Area Transit Regulation Compact (Compact),[9] the Commission promptly suspended the new tariff pending a determination as to its reasonableness, and thereafter conducted a public hearing on the proposals it contained.

On January 26, 1966, in purported response to our remand, and without prior notice or further hearing for the

---

theory in its ratemaking activities, see *Transit I, supra* note 1, 121 U.S.App.D.C. at 379 n. 3, 350 F.2d at 757 n. 3, and this margin translates to an operating ratio of 95.13.

[5] *Transit I, supra* note 1, 121 U.S.App.D.C. at 402, 350 F.2d at 780.

[6] *Ibid.*

[7] The calendar year 1966 was chosen as the future annual period for the projection of the operating results the new tariff was designed to achieve, and the 12-month period ending June 30, 1965, was employed as the historical test year. Neither selection is contested here.

[8] As previously, see note 3, *supra*, tokens would be sold in units of four. Thus the new tariff would increase the unit price from 85 cents to $1.00.

[9] Tit. II, art. XII, § 6(a). The Compact is incorporated into Pub. L. 86-794, 74 Stat. 1031 (1960), and is set forth in full following D.C. Code § 1-1410 (1967 ed.). Amendments to the Compact appear as a part of Pub. L. 87-767, 74 Stat. 765 (1962), and are set forth following D.C. Code § 1-1410a (1967 ed.).

purpose, the Commission entered Order No. 563,[10] in supplementation of Order No. 245, reaffirming the return for 1963 the latter had previously allowed.[11] It simultaneously issued Order No. 564,[12] in which it found that a margin of return for 1966 of about $2,000,000 above operating revenues, symbolizing a return rate of 6.03%, would be fair and reasonable,[13] but that the existing fare scale would generate net earnings estimated at only $648,357.[14] The Commission nonetheless felt that a fare increase, save in a minor respect not questioned here, was unnecessary because of the availability of $2,166,933 in a special reserve which had been created in consequence of our decision in *Bebchick* v. *Public Utilities Commission*.[15] In lieu of an increase, the Commission permitted Transit to draw upon the reserve for approximately $1,350,000 to accommodate the anticipated deficit in its earnings.[16]

Timely petitions for rehearing,[17] denied by the Commis-

---

[10] *In re D. C. Transit Sys., Inc.* (Order No. 563), 63 P.U.R.3d 32 (1966).

[11] The Commission's supplemental findings in Order No. 563 purport to rest on the evidence developed in the 1963 hearing and on certain of the evidence adduced at the hearing in 1965.

[12] *In re D. C. Transit Sys., Inc.* (Order No. 564), 63 P.U.R.3d 45 (1966).

[13] *Id.* at 68, 69. This represents an operating ratio of 93.97.

[14] *Id.* at 58, 68.

[15] 115 U.S.App.D.C. 216, 232-33, 318 F.2d 187, 203-04 (*en banc*), *cert. denied* 373 U.S. 913 (1963). We discuss the origin and purpose of the reserve *infra* pt. III at notes 190 to 195.

[16] *In re D. C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 68-69. The Commission found that this arrangement and other accounting procedures it prescribed would, during the future annual period, provide Transit with net operating income of $2,009,122. *Ibid.*

[17] Compact, *supra* note 9, tit. II, art. XII, § 16.

sion, ripened for our present review[18] various issues stemming from these orders.[19] No. 20,200 brings contentions that Order No. 563 is invalid for lack of notice and hearing, and is erroneous on the merits. No. 20,201 presents importantly the claim that the margin of return awarded by Order No. 564 is unreasonable, and it, like No. 20,202, includes attacks upon other Commission findings and conclusions. We proceed now to a consideration of the problems thus engendered, in the sequence[20] we deem best suited to exposition of the reasons for which we set each of the Commission's orders aside.

---

[18]Compact, *supra* note 9, tit. II, art. XII, § 17(a); Pub. L. 86-794, 74 Stat. 1031, § 6 (1960).

[19]Petitioners in No. 20,200 are two riders who, in protest of the fare increase, participated in the proceeding leading to Order No. 245 and intervened on the former appeal. The United States, also an intervenor on that appeal, does not seek a further review. Petitioners in No. 20,201 are two additional riders (one of whom is counsel of record for petitioners in Nos. 20,200 and 20,201) and the Democratic Central Committee of the District of Columbia, who opposed the increase Transit sought in 1965. Transit is the intervenor in Nos. 20,200 and 20,201, and the petitioner in No. 20,202.

[20]In pt. I, we study Orders Nos. 245 and 563 in their relation to the margin of return allowed for 1963. In pts. II to VII, we deal with contentions as to an assortment of determinations set forth in Order No. 564. Pt. II probes a Commission-ordered extension of the period for amortization of the balance in Transit's acquisition adjustment account. Pt. III scrutinizes the Commission's handling of a deficiency in Transit's reserve for depreciation on its operating properties. Pt. IV examines the Commission's management, for rate-making purposes, of Transit's investment credits against federal income taxes. Pt. V inspects the Commission's treatment of Transit's additional District of Columbia income taxes resulting from a deferral of deductions on track removal and street repaving expenses. Pt. VI analyzes the Commission's estimate of Transit's costs for maintenance of its buses during the future annual period. Pt. VII considers the Commission's finding and rationale on the margin of return for 1966. In pt. VIII, we recapitulate the procedures required for our disposition of the various issues tendered for decision.

I
1963 Margin Of Return

Following our remand, the Commission promulgated in Order No. 563 its supplemental findings to Order No. 245, and "affirmed" its earlier finding that a margin of return representing a rate of 4.87% on operating revenues "was fair and reasonable."[21] Petitioners in No. 20,200 attack Order No. 563 on the ground that it does not comply with our instructions governing the Commission's task on remand.[22] The disclosures made by the record, now to be delineated, lead us to agree.

We pointed out in *Transit I* that the return of 4.87% possesses no inherent validity, and voiced our "need to know more than we have been told about why the Commission thought this was the appropriate margin."[23] We observed that the margin of return properly allowable over

---

[21] *In re D. C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 44.

[22] Petitioners also found a claim of infringement of their statutory and constitutional rights upon the fact that Order No. 563 was formulated without any notice or hearing specifically related to that purpose. Our disposition, on other grounds, of that order renders unnecessary a consideration of that contention. Compare *Bush* v. *Texas*, 372 U.S. 586, 590 (1963); *Barr* v. *Matteo*, 355 U.S. 171 (1957); *Rescue Army* v. *Municipal Court*, 331 U.S. 549, 568 (1947).

One additional question arising from our prior remand in *Transit I* —the matter of overaccrued depreciation on Abandoned Rail Property —is raised by petitioners in this proceeding. Petitioners seem to suggest that having found that there existed an overaccrual as of August 15, 1963, the Commission was barred by our opinion in *Transit I* from off-setting this by any under-accrual of depreciation of other properties during the period in question. It is enough to say with respect to this contention that there is no suggestion in our remand opinion that any such mechanical limitation on the Commission's discretion was intended. Consequently, we find no error in the Commission's treatment of this point on remand.

[23] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

legitimate operating expenses is "the sum of money needed to attract the capital, both debt and equity, required to insure financial stability and the resulting capacity of the utility to render the service upon which the public depends."[24] And we stressed the necessity for

> "inquiries and findings—judgmental as the latter may often be because ratemakers must be prophets of the future as well as historians of the past—into such things as the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2."[25]

Despite these explicit guidelines, we search in vain the Commission's supplemental opinion for the vital findings, or for any manifestation that the Commission has made the inquiries referred to.

The bulk of Order No. 563 is devoted to a summary of the testimony of various witnesses given during the 1963 hearing. The summary covers such matters as Transit's rate base; the capital structures of Transit and other utilities; Transit's cost of capital and that of other utilities; the degree of risk borne by Transit shareholders, as compared with other regulated utilities; dividends and earnings of Transit and its parent,[26] and those of other utilities; Transit's estimated debt expense for the future annual period; actual and authorized operating ratios of Transit and other

---

[24] *Ibid.*

[25] *Ibid.*

[26] Transit is the wholly-owned subsidiary of D.C. Transit System, Inc., a Delaware corporation.

utilities; and the average market prices of the stock of Transit's parent. Having thus reviewed the record in somewhat greater detail than in its original order, the Commission then simply reaffirmed its earlier conclusion on the rate of return in language strikingly reminiscent of that which when remanding we had characterized as "stock generalizations which serve only to frustrate, rather than illuminate, judicial review:"[27]

> "We have before us then an abundance of testimony relating to returns authorized and/or earned by transit companies, telephone companies, electric companies, and gas companies. This information allows us to examine earnings on investments carrying, to some degree, a comparable risk, and are of some value when considered in relation to this particular company. No single rate of return is universally applicable to all transit companies in the United States. A fair rate of return varies with the times and conditions of a particular company as these conditions and opportunities exist at the time of the weighing of the facts in the making of a determination. What constitutes a reasonable rate of return is a question of fact, the solution of which calls for the exercise of sound judgment and common sense by the Commission.
>
> "We have weighed very carefully all testimony and exhibits in this proceeding, along with supplemental data where noted. We are of the opinion that fares producing an operating ratio in the range of 95 to 95.5 constituted a fair and proper return. The projected net operating income of $1,480,000 was the amount necessary to enable Transit to service its debt, pay reasonable dividends, retain a reasonable portion in its business, and to attract investments of private investors. It was, in addition, the amount necessary to maintain investor confidence and to protect the company from the risks peculiar to the transit industry and to Transit itself."[28]

---

[27] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[28] *In re D. C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 40-41.

Dividend Payout

The Commission's opinion is almost wholly devoid of any indication of the method by which it calculated that a margin of return of $1,480,000 was fair and reasonable. The Commission did account for a portion of that sum by finding that a dividend payout of $500,000 would be reasonable—apparently in response to our observation that "Transit's annual dividend pay-out of about $500,000 appears to have been treated as if it were a cost of operation, like the annual expenditures for gas and oil, with no examination of, or conclusion about, its appropriateness."[29] Our concern, however, is hardly alleviated by the Commission's treatment of this point on remand:

> "While there was no direct testimony as to the dollar amount required to be available for dividends, the record does show that $500,000 has been paid out annually over past years to the investors. In view of the fact that in the past three years the market price of the parent company has been relatively stable, it appears to us that the margin of profit allowed by the Commission was fair and reasonable to both the investor and the consumer."[30]

The Commission's stock price stability theory cannot survive close scrutiny. A stable market price could indicate that a constant dividend yield has been consistently too high or too low, as well as that it has been fair and reasonable.[31]

---

[29] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[30] *In re D. C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 41.

[31] In addition to the apparent unreliability of stock price stability as an indicator of the appropriateness of a given level of dividend payments, evidence in the record suggests that the market price of D.C. Transit (of Delaware) stock has not been nearly as stable as the Commission seems to feel. The average yearly market price—the average of high and low prices in a year—varied by as much as 14.6% during the years cited by the Commission. Moreover, the Commission has apparently not inquired into the significance of market price fluctuation within the years in question, and petitioners cite in their

Moreover, the theory finds little support in the record,[32] and we have been referred to no authority buttressing the validity of this method of establishing the appropriateness of a dividend.[33] Thus we are left, as before, without an acceptable rationale for a dividend payout of $500,000, but

brief data showing substantial fluctuation within those years. For example, they state that the low for D.C. Transit (of Delaware) Class A public shares in 1960 was 8½ while the high in 1961 was 14 3/8. And finally, the Commission, in utilizing figures as to the market price of D.C. Transit (of Delaware) stock in demonstrating the appropriateness of a given level of dividend payout by Transit, has failed to comment on the significance of evidence in the record that of the $500,000 dividend paid by Transit to its parent, see note 26, *supra*, only $400,000 has historically been passed on to D.C. Transit (of Delaware) stockholders. In a later rate order, the Commission commented on the unreliability of employing market price figures for Transit's parent in determining a proper return for Transit. Order No. 656 (unreported) (WMATC Jan. 12, 1967).

[32] One witness did testify in the 1965 proceeding that "[t]he market place now assumes continuation of this $500,000 pay-out which has occurred every year since 1960. If this annual pay-out is not continued, the adverse effect on the market value of D.C. Transit System, Inc. (Delaware) stock would be considerable and the financial stability of D.C. Transit would deteriorate in the eyes of the financial community." However, to the extent that this testimony relies on past dividends to justify the current dividend payout, it continues the approach we criticized in remanding, for it treats the $500,000 payout as a "cost of operation," without any consideration of its "appropriateness." *Transit I*, 121 U.S.App.D.C. at 401, 350 F.2d at 779. We are unable to see how the Commission could reach a judgment as to the "appropriateness" of a particular dollar amount of dividends paid without inquiring into such things as the relationship between dividends and book equity per share, the relationship between dividends paid and market price per share, and a comparison of such figures with those for other companies of comparable risk.

[33] "The 'expertise' of a commission usefully serves it in evaluating the evidence, but that expertise can not supply evidence and can not, without findings made upon the critical issues before it, guide a commission to a rational and lawful decision." *Capital Transit Co.* v. *Public Utils. Comm'n*, 93 U.S.App.D.C. 194, 205, 213 F.2d 176, 187, *cert. denied* 348 U.S. 816 (1954).

only the fact that over a period of years Transit has paid annual dividends in that sum.

Return on Rate Base

The Commission's ratemaking responsibilities are by no means exhausted by any determination it may make as to a fair dividend.[34] Even were we able to sustain the Commission in that regard, we would not be enabled thereby to affirm the Commission's allowance of a total return of $1,480,000. What is needed is a reasoned justification of the end result—the entire excess of gross operating revenues allowed over operating expenses. Here, however, the Commission does not provide any suitable explanation of or support for its ultimate conclusion that a margin of return of $1,480,000 is fair and reasonable. Save for its verdict with respect to the dividend payout, the only concrete finding that the Commission made is that the authorized margin of return would be equivalent to a return on rate base of approximately 6½%.[35] We express no view on the reasonableness of such a return on rate base, nor on the accuracy of the Commission's statement that such a return is "con-

---

[34] Indeed, though the Commission should certainly take into account whether the return it allows will enable the company "to pay dividends sufficient to continue to attract investors," *Transit I*, 121 U.S.App.D.C. at 400, 350 F.2d at 779, such consideration is more properly viewed as a means of checking the reasonableness of the overall return authorized rather than as an independent starting place for analysis. For, as the Commission has recognized in a later rate order, the payment of dividends is a matter primarily entrusted to managerial discretion and not subject to direct control by the Commission. Order No. 684 (unreported) (WMATC Mar. 13, 1967). Moreover, it would seem that in computing a capital-attracting rate of return there is little reason to distinguish between that portion of net income which is to be paid out in dividends and that portion which is to be retained in a capital account. See Bonbright, Principles of Public Utility Rates 250-51 (1961).

[35] *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 41.

servative."[36] We do stress, as we did in our former opinion, that testing the reasonableness of an operating ratio by reference to the return on rate base, while sometimes useful, "can never be conclusive. The important thing is not that the result reached by the operating ratio method be compared with that which would have been reached under some other method, but that the operating ratio method be applied rationally and intelligibly in the first instance."[37] Absent a calculation of operating ratio responsive to the considerations enumerated in our opinion remanding the Commission's reference to return on rate base could not provide independent support for the result it reached.

Costs of Capital

On our prior review, we took note of the Supreme Court's statement in *FPC* v. *Hope Natural Gas Co.*[38] that "in balancing investor and consumer interests, it is essential to consider the capital costs of the enterprise."[39] We emphasized that the operating ratio method does not make an inquiry into capital costs irrelevant, and that indeed "it was in part the failure of rates established by the rate base method to cover the capital costs of most motor carriers" that gave birth to the operating ratio method.[40]

During the course of the 1963 hearing, both Transit and the protestants[41] submitted evidence relating to Transit's cost of capital. Transit's expert witness testified to a combined cost of debt and equity capital for Transit of 7.8%,

---

[36] *Ibid.*

[37] 121 U.S.App.D.C. at 399 n. 56, 350 F.2d at 777 n. 56.

[38] 320 U.S. 591, 603 (1944).

[39] 121 U.S.App.D.C. at 400, 350 F.2d at 778.

[40] *Ibid.*

[41] The petitioners in No. 20,200 participated in the proceeding before the Commission as protestants. Other protestants and an intervenor in the Commission proceeding are not parties here.

derived from industry averages.[42] He stated further that this figure could not itself be taken to represent a fair return, but would have to be adjusted upward, to about 10%, to allow for a reasonable addition to surplus.[43] The 10%, he said, could be applied to the "physical value of the plant that is devoted to public service" in order to determine a fair return.

Protestants' expert recommended that Transit be permitted to earn gross revenues sufficient to provide a return on its equity capital of 12% after allowing for operating expenses and interest on its debt. He reached this figure after study of the earnings-price ratios of Transit's corporate parent[44] and 12 urban transit companies that he felt were "most comparable" to Transit. Over the ten-year period from 1952 through 1961, he found, the average of the 12 companies was approximately 11%. This he increased to 12% to compensate for the increased risk borne by Transit's shareholders emanating from Transit's abnormally high debt-equity ratio.[45] He stated that the 12% could be applied to Transit's average book equity for 1963 in order to provide a fair return on equity.[46] He then added the resulting figure to Transit's estimated debt expense for the test period, and arrived at a sum which he felt should

---

[42]See *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 37.

[43]*Ibid.*

[44]See note 26, *supra*.

[45]See *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 39.

[46]See *id.* at 39-40. The witness' overall objective was to provide a return that would maintain the market price of a share of Transit stock at about its book value. Though at least one commentator has approved this approach, not all commentators have accepted its validity. Compare Note, *An Earnings Price Approach to Fair Rate of Return in Regulated Industries*, 20 Stan.L.Rev. 287 (1968) with Bonbright, *supra* note 34, at 254-56.

be allowed as the margin of return over operating expenses.[47]

The Commission made no findings based on any of this evidence, and did not analyze the cost of capital testimony of Transit's expert witness. With respect to the testimony of protestants' expert, the Commission had only this to say:

> "Moreover, we have considered but placed little emphasis on protestant's recommended rate of return utilizing the cost-of-capital method. It should be noted that more traditionally the computation of the cost of capital is done by determining the cost of debt and of equity and weighting the two for a composite rate. The protestants in this case disregarded this traditional method. We feel that the cost-of-capital method utilized is inappropriate in determining a proper rate of return for a transit company. Our view is reinforced when we consider the capital structure of this particular company. Other factors in addition to cost of capital should be considered in making the return allowance. These additional factors include the degree of risk involved, a comparison of earnings, the ability to attract capital, the economic conditions of both the market place and the community, the efficiency of management, and the contribution to surplus. We have seen that the recommendation of the protestant's expert witness is based not on a mathematical formula but a weighting of any [*sic*] judgmental factors. Thus, the 'judgment' factors tend to undermine the objectivity of the end results. This is especially true when the answers given by the witness on his cross-examination are compared with his direct testimony."[48]

We are unable to understand the Commission's failure to make findings on the critical cost of capital factor. Nor

---

[47]The witness recommended that Transit be permitted to earn a total margin of return of $1,107,000 comprised of an allowance for estimated debt expense of $602,089 and a return to the equity holder of $504,838. See *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 39.

[48]*In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 41-42.

are we persuaded by its stated reason for rejecting the approach taken by protestants' expert.

In the first place, that protestants' expert "disregarded" the "traditional method" and testified to a cost of equity capital, rather than an overall or combined cost of capital, does not appear to us to deprive his testimony of utility. The witness explained why he talked in terms of a cost of equity capital: "I do not employ a composite rate of return, as I believe that my method of allowing the actual interest expenses, and a determination of the return on the actual equity investment is simpler and gives approximately the same result." Had the Commission desired, the protestants' figure for cost of equity capital could have been transformed quite easily into a figure representing a combined cost of debt and equity capital.[49] As we have noted, Transit's witness did testify to an overall cost of capital.[50]

We are also puzzled by the Commission's statement that "the cost of capital method . . . is inappropriate in determining a proper rate of return for a transit company," and we do not understand how this view is "reinforced" by reference to "the capital structure of this particular company." Indeed, it is difficult to see how else the Commission could hope to determine "the sum of money needed to attract the capital, both debt and equity, required to insure financial stability" than through an analysis of the sort

---

[49]Having computed an estimated cost of debt, but see note 68, *infra*, and having arrived at a cost of equity capital, an overall cost of capital could be derived as follows: The estimated cost of debt is multiplied by a fraction representing the proportion which debt capital bears to the company's overall capitalization. The estimated cost of equity capital is multiplied by a fraction representing the proportion which equity capital bears to the company's overall capitalization. The two figures are then added to give the overall cost of capital. See Leventhal, *Vitality of the Comparable Earnings Standard for Regulation of Utilities in a Growth Economy*, 74 Yale L.J. 989, 992-93 (1965); Note, *An Earnings-Price Approach to Fair Rate of Return in Regulated Industries*, 20 Stan.L.Rev. 287, 293-94 (1968).

[50]See note 42, *supra*, and accompanying text.

proposed by the two expert witnesses.[51] And though Transit's unusual capital structure may have a bearing on its costs of acquiring debt and equity capital,[52] it is unclear why that factor precludes ascertainment and consideration of such costs at all.[53]

---

[51] See Bonbright, *supra* note 34, at 250-54, Leventhal, *supra* note 49, at 992-93.

[52] Protestants' expert testified that "there is . . . a pretty well-founded theory, that if equity stock, common stock, is preceded by a high debt ratio–that [investors] . . . will want a somewhat higher earnings-price ratio because . . . they fear [the] . . . great leverage that those high preferred charges on income will have on their earnings." Accordingly, he adjusted his recommended figure for return on equity capital to reflect the higher risk resulting from Transit's heavy debt capitalization. See also note 60, *infra*.

[53] Though the Commission did not so state in its opinion, there may be difficulties in applying to Transit an attraction-of-capital analysis utilizing earnings-price ratios, flowing from the fact that its stock is wholly owned by its parent Corporation, D.C. Transit of Delaware, and thus has no market price of its own. Other commissions have generally not found this an insuperable obstacle to utilization of an attraction-of-capital approach. See, *e.g.*, authorities discussed in Nichols, *Ruling Principles of Utility Regulation–Rate of Return*, 250-62 (1955); Nichols & Welch, *Ruling Principles of Utility Regulation–Rate of Return*, 129-43 (Supp. A 1964). A witness in the 1963 proceeding testified that the publicly traded stock of D. C. Transit of Delaware was a "good index" of Transit's cost of capital. A witness in the 1965 proceeding testified that "as of the present . . . it is acceptable to ascertain the relevant data concerning D. C. Transit Company (Del.) and impute from that a cost of equity capital for the local company. This approach is followed in many rate proceedings where the equity capital of the company in question is wholly owned by the parent." Moreover, though in a later proceeding the Commission declined to place substantial reliance on analyses of the market behavior of the stock of Transit's parent, see note 31, *supra*, at a later stage of the same proceeding the Commission adopted an approach which entailed a determination of Transit's cost of capital, though without reference to earnings-price ratios. Order No. 684, *supra* note 34.

Because of the extraordinary difficulties in determining cost of capital for a corporation which is part of an elaborate holding company

Comparable Earnings

By including "a comparison of earnings" in its list of "additional factors" the Commission may have had reference to *FPC* v. *Hope Natural Gas Co.*,[54] where the Supreme Court said that

> "*the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.* That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[55]

As various commentators have noted,[56] implicit in this language are two methods for determining a fair rate of return. One, commonly referred to as the "attraction of capital" standard, attempts to do so by looking to the capital costs of the enterprise as reflected in earnings-price ratios. The other, frequently denominated the "comparable earnings" standard and suggested by the italicized portion of the language quoted, is based on a comparison of the return on equity of the subject company with the returns afforded by other companies. Thus, while we are unable to accept the Commission's reasons for rejecting the cost of capital evidence presented to it, we certainly do not intend to inti-

---

structure, the Commission would no doubt be better able to fulfill its regulatory responsibilities were Transit to maintain a separate corporate existence. A suggestion to this effect, addressed by the Commission to Transit, might well be an appropriate means of alleviating some of the regulatory problems illustrated by this case. In Order No. 564, the Commission referred to the problem posed by integration of Transit's bus operations with non-transit operations, and urged the company to separate "completely its transit and non-transit activities so that Transit's personnel will not be involved in non-transit functions." (p. 4) This request was promptly complied with. (Order No. 656 p. 5.)

[54] *Supra* note 38.

[55] 320 U.S. at 603 (emphasis added).

[56] Bonbright, *supra* note 34, at 256-57; Leventhal, *supra* note 49, at 992.

mate any disagreement with the Commission's statement that "a comparison of earnings" is an additional factor to be considered.[57] On the contrary, we strongly admonish that a comparison of the returns being afforded Transit's shareholders with those of other companies of corresponding risk is necessary to a responsible determination of the proper margin of return which Transit should be allowed.[58]

[57]We readily admit, however, to considerable confusion as to the remainder of the Commission's enumerated list of "other factors" (than cost of capital) it considers significant. One of the "additional factors" listed, the "ability to attract capital," may simply be another way of denominating the cost of capital as derived from earnings-price ratios. See note 51, *supra*, and accompanying text. Others of the factors named—the degree of risk, "the economic conditions of both the market place and the community," the "efficiency of management," and the need for a contribution to surplus to allow for forecasted capital expansion—we understand to be considerations which the Commission might weigh in determining whether a particular return derived from an earnings-price analysis or a comparison of earnings of other companies would in fact provide Transit with a fair return. See Nichols, *supra* note 53, at 195-207; Nichols and Welch, *supra* note 53 at 78-79. The particular degree of risk borne by Transit's shareholders, for example, is a factor which must be evaluated by the Commission especially in applying the comparable earnings standard, but probably also in utilizing an attraction of capital approach which looks to earnings-price ratios of other companies. This is a matter requiring the exercise of informed judgment by the Commission, since it is no doubt impossible to find a company whose risk is identical to Transit's, and averaging figures for a number of companies tends to subsume differences in risk among the companies studied in a manner inconsistent with application of those figures to a particular company. But that does not make such inquiries irrelevant, nor does it relieve the Commission of the responsibility to reveal to a reviewing court the path it has followed, and the manner in which it has quantified its judgment.

[58]Commentators have differed as to whether the comparable earnings or the attraction-of-capital standard is the approach which should be given primary weight in a rate proceeding. Compare Leventhal, *supra* note 49, at 994-95 with Bonbright, *supra* note 34, at 257-58. We perceive no obstacle, and each of these commentators would apparently agree, to the employment of both methods in a given proceeding—though, as we have noted, Transit's status as a subsidiary

Notwithstanding the Commission's allusion in this case to the comparable earnings standard,[59] it is clear that it made no meaningful evaluation of the level of returns being afforded Transit shareholders.

In remanding, we noted that, at the time Transit began operations, the company's heavy debt capitalization[60] "made inevitable large returns on equity to the extent that the relatively heavy interest requirements were safely covered and the gamble on traffic levels after the resumption of operations was won."[61] But we added that:

> "The urgency of the problem of traffic uncertainty has, however, receded appreciably into the past. Although it continues to exist to some degree by reason of the seemingly inexhaustible enthusiasm of motorists and highway builders, on the one hand, and persistent

---

corporation may be a reason for placing less reliance on earnings-price statistics. See note 53, *supra;* see also *Permian Basin Area Rate Cases,* 36 U.S.L.W. 4337, 4353 (U.S. Apr. 30, 1968).

[59] In addition to its reference to "a comparison of earnings," see *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R. 3d at 40, quoted in the text at note 28, *supra.*

[60] Transit's capital structure continues to be very heavily weighted in favor of debt, and, in fact, the percentage of debt capitalization apparently is still growing. In 1963, debt capital comprised 73.74% of total capitalization; the corresponding figure for 1965 is 77.68%. In remanding, we observed that "the desirable ratio of debt to equity" is one of the matters which "must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2." 121 U.S.App.D.C. at 401, 350 F.2d at 779. A very high debt-equity ratio may have beneficial effects for the ratepayer, since debt capital costs less to acquire than equity capital, and since interest payments are deductible expenses for tax purposes while dividends are not. See *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 43. On the other hand, as the Commission recognized, *ibid.*, a very high debt-equity ratio may increase the costs of both debt and equity capital. See note 52, *supra.* It may be that, on balance, a saving in total capital costs is effected by a high debt-equity ratio. But the Commission has not yet made the findings which would warrant such a conclusion.

[61] 121 U.S.App.D.C. at 402, 350 F.2d at 780.

> speculation about rail rapid transit, on the other, we think the time has come for the Commission to make a careful review and analysis of the earnings experience of Transit from its inception, and of what that experience has meant to the equity owners, both by way of dividend payments and growth in book values through retained earnings. We do not see how current fare increases can properly be appraised apart from such a study, and the reflection of its results in the articulation of the Commission's decision as to the margin of revenues over expenses appropriate to today's needs, as distinct from the crisis conditions of nearly a decade ago."[62]

The Commission responded to these comments by setting forth gross statistics on Transit's total and average-per-year retained earnings over a nine-year period, and the range of net operating income figures over that period. It observed that "the rate of dividend growth has been zero since 1960," noted "little growth trend in the earnings per share," and stated that "[t]he degree of stock price stability in the market place indicates to us that earnings in the past have not been excessive."[63] The Commission's approach thus appears to have been to justify current earnings and dividends by reference to those of the past, in clear contrast to our mandate that the Commission articulate its "decision as to the margin of revenues over expenses *appropriate to today's needs as distinct from the crisis conditions of nearly a decade ago.*"[64]

---

[62] *Ibid.*

[63] *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 43. Compare notes 30-33, *supra*, and accompanying text.

[64] Emphasis added. The Commission did not respond to our direction that it evaluate the level of returns now being earned by Transit in the light of *current* risks and other factors which would bear on their reasonableness, as contrasted with the conditions which prevailed when Transit began operations. We think it significant in this regard that when, in a later proceeding, the Commission *did* make such an analysis of current risks, it concluded:

> "[T]he company faces less risk than most transit companies because of its size, its position in the holding company corporate

There is much information in the records of both the 1963 and 1965 rate proceedings relative to Transit's return on equity, as well as the returns being earned by companies with which Transit might be compared,[65] but the Commission made no findings based on any of this evidence. We respect the Commission's primary fact-finding responsibility, but we cannot ignore the substantial indications in the record that the Commission has permitted Transit to earn extraordinarily high returns on its investment. The protestants in the 1963 proceeding introduced evidence that Transit's average book equity for 1963[66] would be $4,206,990,[67] and its debt expense for that period $602,089.[68] On this basis the total return of $1,480,746

---

structure of which it is a part, its prospects for future growth in its transit operations, and, finally, the cushion provided by the increasing value of its real estate. . . . [I]n our view, the company presently faces less risks than it may have in the past."

Order No. 684, *supra* note 34.

[65]Though the *Hope Natural Gas* case speaks of comparing earnings with those of companies "having corresponding risks," see text *supra* at note 55, that language should not be taken as placing upon the Commission the difficult, if not impossible, task of finding a company with *identical* risks. See Leventhal, *supra* note 49, at 998-1003, 1013-16. Rather, a sensitive application of the comparable earnings approach embraces comparisons with companies having dissimilar risks, "with appropriate adjustments for the differences involved." *Id.* at 1003; see *Permian Basin Area Rate Cases, supra* note 58, 36 U.S.L.W. at 4353-54. That the process demands the exercise of informed judgment does not, we stress, dispense with the need for reasoned analysis and findings. See note 57, *supra*.

[66]The calendar year 1963 was used as the future test period in this proceeding. *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 390.

[67]In fact, this prediction was probably quite accurate, since an exhibit in the record of the 1965 proceeding shows Transit's actual book equity in 1963 to have been $4,184,080.

[68]In remanding, we stressed the need for inquiry by the Commission into "the cost to Transit of borrowing money," and "what Tran-

allowed by the Commission represents a return on equity of $878,657, or approximately 21%.[69] Transit introduced data showing the average earnings on common stock equity of 15 transit companies for 1959-61 to be 8.7%,[70] and the protestants showed average earnings on book equity of 12 transit companies for 1952-61 to be 7.5%.

Transit's evidence in the 1965 proceeding discloses the average return on book equity for 18 urban transit companies for the period 1960 to 1964 to have been

---

sit's future requirements in this regard are likely to be." 121 U.S. App.D.C. at 401, 350 F.2d at 779. But though the Commission in its supplemental opinion purports to have computed a return sufficient, *inter alia*, "to enable Transit to service its debt," *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 41, nowhere in its opinion does there appear a finding as to the company's estimated debt expense for the future test period.

[69]The Commission made no finding as to the return on equity which would result from allowance of an overall return of $1,480,000; indeed, since it did not estimate the cost of servicing Transit's debt during the future annual period, see note 68, *supra*, it could not, as the following hypothetical example shows: Given a figure for book equity of $4,000,000 and an allowed total return of $1,000,000, the return to the equity holder would be $800,000, or 20%, if debt expense were $200,000; if debt expense were $800,000, the return to the equity holder would be only $200,000, or 5%.

> "[T]he return to each class of security holder is relevant in judging whether a given overall rate of return is reasonable. Due to the relatively low cost of debt financing, an overall rate of return of 5.6 per cent might yield a return to common stockholders of 6 or 7 per cent in a utility with little debt but yield a much higher return to common shareholders of a highly leveraged utility with a high percentage of debt in its capital structure. Neither the Commission nor the courts may ignore this fact." *City of Alton* v. *Commerce Comm'n*, 19 Ill.2d 76, 165 N.E.2d 513, 519 (1960).

Without having estimated Transit's debt, and having been disabled thereby from computing and evaluating the return to equity holder, we are at a loss to understand how the Commission could conclude that $1,480,786 is a "fair and reasonable" margin of return.

[70]This figure, as well as some of those that follow, is derived by averaging a group of figures set forth in an exhibit or exhibits.

approximately 4.5%, while Transit's average return on book equity for the same period was 23.3%. Protestants introduced exhibits revealing that, for the period 1959 to 1964, Transit's average return on book equity was 24.01% while the average for ten transit companies for that period was 9.45%.

One witness in the 1963 proceeding testified that Transit had experienced "abnormally high earnings on the equity investment," and calculated that over a six-year period Transit had accrued earnings in excess of "fair annual earnings on book equity," which he set at 14%, in the amount of $3,882,000. Another witness in the 1965 proceeding testified that

> "when one looks at the figures [representing Transit's return on equity] . . . one wonders whether or not he is looking at the figures for a regulated utility . . . [T]here are many highly speculative industries which would like to be able to hold out such high returns to the equity investor. *I know of no other utility company that can show as high a return on equity, on average, as this one.*"[71]

---

[71] Emphasis added. *Cf. Bluefield Co.* v. *Public Serv. Comm'n*, 262 U.S. 679, 692-93 (1923):

> "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."

One witness in the 1965 proceeding did testify that a return of 20.97% would be "low," basing his conclusion on "the high debt ratio of D.C. Transit and the risk associated in the transit industry generally and D.C. Transit in particular." He added that in his opinion a return on equity of 25% or 30% for Transit would be "entirely reasonable." However, he admitted on cross examination that he had never recommended, and knew of no proceeding in which had been granted, a return of 25% to 30%. And see note 64, *supra*. Order No. 684, *supra* note 34, the Commission permitted a return on equity of 14%.

We do not decide, whether, based on this record, the Commission could have made a sustainable finding that the return allowed by Order No. 245 was "commensurate with returns on investments in other enterprises having corresponding risks."[72] In view of the Commission's failure to make a finding one way of the other on that question, no such inquiry on our part is called for.[73] We do think, however, that the Commission's failure to deal meaningfully with the evidence we have summarized is significant as a further indication that it has misconceived the nature of its responsibilities and the kind of inquiries and determinations that must be made in setting rates under the operating ratio method. In the absence of any inquiry into the appropriateness of the returns being afforded Transit shareholders in in the light of returns being earned by other companies of comparable risk,[74] the peculiar risks borne by Transit shareholders,[75] and any other relevant factors, we are unable to conclude that the Commission has responsibly complied with its statutory mandate to prescribe just and reasonable fares.

In sum, we find in the Commission's supplemental opinion little in the way of "particularized reference" to the matters discussed in our remand opinion, none of the essential findings called for, and no manifestation of inquiry into any of the considerations "which must be prayerfully

---

[72] *FPC* v. *Hope Natural Gas Co.*, *supra* note 38, at 603.

[73] See *Atchison Ry.* v. *United States*, 295 U.S. 193, 201 (1935); *Florida* v. *United States*, 282 U.S. 194, 215 (1931); *Anglo-Canadian Shipping Co.* v. *FMC*, 310 F.2d 606, 617 (9th Cir. 1962); *Bell Lines, Inc.* v. *United States*, 263 F.Supp. 40, 44 (S.D.W.Va. 1967). In view of our conclusion, see the text *infra* at 82-83, that there is no occasion for a further remand of this case, we do not consider whether we might properly make such a determination for the Commission's guidance in further proceedings. See *Inland Motor Freight* v. *United States*, 60 F.Supp. 520, 527 (E.D.Wash. 1945).

[74] See note 65, *supra*.

[75] See note 64, *supra*.

explored by the conscientious regulator before he can begin to say why he fixed upon 4.8 rather than 6.5 or 3.2."[76] Instead, it has clearly treated Transit's $500,000 dividend payout as a "cost of operation" without any inquiry into its appropriateness. It has dismissed evidence as to Transit's cost of capital as "inappropriate." And it has made no meaningful evaluation of the returns being afforded Transit shareholders. We think it evident that, though purporting to equate a fair return with "the amount necessary to enable Transit to service its debt, pay reasonable dividends, retain a reasonable portion in its business, and to attract investments of private investors,"[77] the Commission has neglected to apply that principle in practice. Under these circumstances, the disposition we should make of the orders under review is a matter of some difficulty, to which we now turn our attention.

Disposition

On our original review of this case in *Transit I*, we were unable to discern from the Commission's opinion the method by which it had computed the return to be allowed Transit. Because the Commission had "described its deliberations and conclusions . . . [solely] in terms of stock generalizations which serve only to frustrate, rather than illuminate, judicial review,"[78] we were left without "an adequate basis for knowing why it did what it did."[79] But notwithstanding our uncertainty as to whether the Commission had actually made the inquiries and the concomitant decisions we held to be required by the statute,[80] we were unwilling

---

[76] *Transit I*, 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[77] *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, at 41.

[78] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[79] 121 U.S.App.D.C. at 402, 350 F.2d at 780.

[80] "It appears to us likely that the Commission too narrowly conceived the scope of its inquiry under the operating ratio method, although, on this record, we can only say that the path

to conclude, merely from the absence of findings in its order, that the Commission had not performed its duties.[81] Thus we did not disturb the effectiveness of the fare increase granted by Order No. 245, nor did we make provisions for restitution by Transit of increased fares collected pursuant to that order.[82] Instead, we remanded to the Commission to enable it to clarify the grounds of its action or, if necessary, to formulate a new order.[83]

The case now before us, however, is quite different. The Commission, once again, does not advance a rational basis for its determination of rate of return—despite the opportunity afforded it to do so, after we had enunciated the applicable principles and emphasized the need for findings.[84]

---

it actually followed cannot confidently be discerned." *Transit I*, 121 U.S.App.D.C. at 399-400, 350 F.2d at 777-78.

[81] See *South Carolina Generating Co.* v. *FPC*, 249 F.2d 755, 764 (4th Cir. 1957), *cert. denied* 356 U.S. 912 (1958).

[82] See *United States* v. *Morgan*, 307 U.S. 183 (1939); *Braniff Airways* v. *CAB*, 113 U.S.App.D.C. 132, 136, 306 F.2d 739, 743 (1962); *Greensboro-High Point Airport Authority* v. *CAB*, 97 U.S.App.D.C. 358, 363, 231 F.2d 517, 522 (1956); *Spiegel* v. *Public Utils. Comm'n*, 96 U.S.App.D.C. 307, 311, 226 F.2d 29, 33, *cert. denied* 350 U.S. 904 (1955); *New York Cent. R.R.* v. *United States*, 207 F.Supp. 483, 498 (S.D.N.Y. 1962), *vacated in part and remanded, sub nom. ICC* v. *Baltimore & O. R.R.*, 355 U.S. 175 (1957) (*per curiam*); *New England Tel. & Tel. Co.* v. *Kennelly*, 81 R.I. 1, 98 A.2d 835, 839 (1953).

[83] See *Mississippi River Fuel Corp.* v. *FPC*, 82 U.S.App.D.C. 208, 224-25, 227, 163 F.2d 433, 449-50, 452 (1947); *South Carolina Generating Co.* v. *FPC*, *supra* note 81, 249 F.2d at 764; *State Corp. Comm'n of Kansas* v. *FPC*, 206 F.2d 690, 722-23 (8th Cir. 1953), *cert. denied* 346 U.S. 922 (1954); and see the cases cited in note 82, *supra*.

[84] See *South Carolina Generating Co.* v. *FPC*, *supra* note 81 (suspending Commission order and remanding for further explanation, because of apparent inconsistency in Commission's recognition of subsidiary corporation as separate entity for purposes of computing income tax expense, while fixing rate of return on system-wide basis); *South Carolina Generating Co.* v. *FPC*, 261 F.2d 915 (4th Cir. 1958) (refusing to accept explanation given by Commission on remand, and

Moreover, it now appears affirmatively that at no time in this proceeding has the Commission made the investigations and the resolutions essential to a legitimate exercise of its authority to prescribe just and reasonable fares.[85] Since we cannot escape the conclusion that the Commission's approval of the fare increase was based upon a mistaken view of its responsibilities in setting rates under the operating ratio method, we hold that Orders Nos. 245 and 563 must be set aside.[86]

---

holding original action unlawful); see also *In re South Carolina Generating Co.*, 22 F.P.C. 188 (1959).

[85]We do not, we hasten to add, suggest improper motives or bad faith. "However, an administrative decision which shows on the face of the order that it was made without due regard for the factors which were required to have been taken into account is just as void as an order made and entered by reason of improper motives." *Roseburg Lumber Co.* v. *Chambers*, 223 Ore. 294, 355 P.2d 606, 614 (1960).

[86]We need not decide whether the absence of express findings in the Commission's order would itself warrant reversal. See, *e.g.*, *Florida* v. *United States*, *supra* note 73, 282 U.S. at 215; *Wichita R.R.* v. *Public Utils. Comm'n*, 260 U.S. 48 (1922). For we think it is clear that agency action must be set aside as unlawful when the absence of findings reflects arbitrariness or misapplication of statutory standards. See *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156 (1962) (commission mistakenly thought it had unlimited discretion to choose either of two remedies, *id.* at 165; choice of remedy must be "rational," and based on "conscious choice" and balancing of public interest, *id.* at 167; commission had not acted with "discriminating awareness" of consequences of its action, *id.* at 176); *Schaffer Transp. Co.* v. *United States*, 355 U.S. 83 (1957); *United States* v. *Carolina Carriers Corp.*, 315 U.S. 475, 488-89 (1942) ("likely" that "an erroneous statutory construction lies hidden in vague findings;" the "requirement [for findings] is not a mere formal one"); *Saginaw Broadcasting Co.* v. *FCC*, 68 U.S.App.D.C. 282, 287, 96 F.2d 554, 559, *cert. denied* 305 U.S. 613 (1938) (findings serve dual function of apprising parties and reviewing court of grounds of decision and, in addition, of guaranteeing that cases decided "according to the evidence and the law, rather than arbitrarily or from extralegal considerations"); *Tennessee Valley Authority* v. *United States*, 96 F.Supp. 409 (N.D. Ala. 1951); *Louisville & Nashville R.R. v. United States*, 268 F.Supp. 71 (W.D.Ky. 1967) (order set aside as "arbitrary" since "it lacks a

The question nonetheless remains whether we should again remand to the Commission, to permit further consideration and a new order. For even where agency action must be set aside as invalid, but the agency is still legally free to pursue a valid course of action, a reviewing court will ordinarily remand to enable the agency to enter a new order after remedying the defects that vitiated the original action.[87] A remand for this purpose, however, necessarily

---

stated rational basis," *id.* at 75, and also because "based upon a misinterpretation or misapplication of the relevant statutory provisions," *id.* at 79); *North Carolina* v. *United States,* 210 F.Supp. 675, *rev'd on other grounds,* 376 U.S. 93 (1964) (report of commission indicates that it did not take critical factor into account); *Seatrain Lines, Inc.* v. *United States,* 168 F.Supp. 819, 827 (S.D.N.Y. 1958) (in addition to absence of findings, orders "on their face affirmatively show" erroneous reliance on previous decision of commission); *Long Island R.R.* v. *United States,* 140 F.Supp. 823, 827, 828-29 (E.D. N.Y. 1956); *City of Alton* v. *Commerce Comm'n, supra* note 69, 165 N.E.2d at 516 (parties and public have right "not just to a reasonable determination but rather to a determination which arises from sound and lawful analysis of the problems presented"); *Illinois Bell Tel. Co.* v. *Illinois Commerce Comm'n,* 414 Ill. 275, 111 N.E.2d 329, 337 (1953); *American Vitrified Prods. Co.* v. *Public Serv. Comm'n,* 176 N.E.2d 145, 153 (Ind.App. 1961); *Roseburg Lumber Co.* v. *Chambers, supra* note 85, 355 P.2d at 614; *In re New England Tel. & Tel. Co.,* 115 Vt. 494, 66 A.2d 135 (1949) (commission order reversed since commission not only failed to set forth findings in its report, but *refused* to make findings on, *inter alia,* rate base and rate of return, in mistaken reliance on "end result" test of *FPC* v. *Hope Natural Gas Co., supra* note 38); *Commonwealth Tel. Co.* v. *Public Serv. Comm'n,* 252 Wis. 481, 32 N.W.2d 247 (1948) (commission allowed "reasonable profit," but made no findings on rate base, in reliance on *Hope Natural Gas Co., supra;* order set aside as "arbitrary and unlawful": "it was not the intention of the legislature to bestow such arbitrary powers upon the Commission," at 248-49); see also *Boudin* v. *Dulles,* 98 U.S.App.D.C. 305, 307-08, 235 F.2d 532, 534-35 (1956).

[87]See, *e.g., Burlington Truck Lines, Inc.* v. *United States, supra* note 86, 371 U.S. at 176; *Florida* v. *United States, supra* note 73, 282 U.S. at 215; *NLRB* v. *Capital Transit Co.,* 95 U.S.App.D.C. 310, 313, 221 F.2d 864, 867-68 (1955); *Anglo-Canadian Shipping Co.* v. *FMC, supra* note 73, 310 F.2d at 614, 618; *Marine Transport Lines, Inc.* v. *United States,* 173 F.Supp. 326, 330 (D.D.C. 1959); *Louisville*

assumes continuing power in the agency to deal with the subject matter of the proceeding. Where, because of changed circumstances,[88] or because of the decisional grounds nullifying the initial order,[89] the agency does not possess that authority, a remand is manifestly unwarranted.

Orders Nos. 245 and 563 have been superseded by later fare orders entered by the Commission subsequent to our remand in *Transit I.*[90] The propriety of another remand thus hangs on the Commission's power to devise a new order, *nunc pro tunc*, governing the years intervening between Order No. 245 and the entry of a subsequent order prescribing the "lawful fare . . . to be in effect."[91] The

---

& Nashville R.R. v. *United States, supra* note 86, 268 F.Supp. at 82-83; *Seatrain Lines, Inc.* v. *United States, supra* note 86, 168 F.Supp. at 827-28; *Inland Motor Freight* v. *United States, supra* note 73, 60 F.Supp. at 527; *City of Alton* v. *Commerce Comm'n, supra* note 69, 165 N.E.2d at 523; see also *FTC* v. *Carter Prods., Inc.*, 346 U.S. 327 (1953) (*per curiam*); *FPC* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952); *Eastern-Central Motor Carriers Ass'n* v. *United States*, 321 U.S. 194, 210-12 (1944); *Mountain States Tel. & Tel. Co.* v. *Public Serv. Comm'n*, 107 Utah 502, 155 P.2d 184, 188 (1945).

[88] *Washington Gas Light Co.* v. *Baker*, 90 U.S.App.D.C. 98, 104, 195 F.2d 29, 35 (1951).

[89] *North Carolina* v. *United States, supra* note 86, 210 F.Supp. at 689-90; see *American Trucking Associations Inc.* v. *United States*, 364 U.S. 1, 15-17 (1960); *General Utils. & Operating Co.* v. *Helvering*, 296 U.S. 200, 207 (1935).

[90] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, continuing, with one minor exception, the fares prescribed in *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2; *In re D.C. Transit Sys., Inc.* (Order No. 684), *supra* note 34, granting increase in token fares, and today affirmed in that respect in *D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, No. 21,029, decided this day.

[91] Compact, *supra* note 9, tit. II, art. XII, § 6(a)(2). *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, was entered April 12, 1963, and the fares prescribed therein were made effective April 14, 1963. *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, was entered January 26, 1966.

Commission, however, possesses no authority to fix rates for the past. An order prescribing the lawful fares to be charged by a public utility, being essentially legislative in character, ordinarily speaks only for the future.[92] And we find nothing in the statutory provisions governing the Commission's regulatory responsibilities[93] that indicates an intent to depart from this "customary pattern of fixing rates prospectively."[94] Hence, we conclude that the Com-

---

[92] *Arizona Grocery Co.* v. *Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932); *Hope Natural Gas Co.* v. *FPC*, 196 F.2d 803 (4th Cir. 1952); *Georgia Pub. Serv. Comm'n* v. *Atlanta Gas Light Co.*, 205 Ga. 863, 55 S.E.2d 618 (1949); *Michigan Bell Tel. Co.* v. *Michigan Pub. Serv. Comm'n*, 315 Mich. 533, 24 N.W.2d 200 (1946).

[93] Compact, *supra* note 9, tit. II, art. XII, § 6(a)(2). It is true that the language of § 6(a)(2) does not expressly deny to the Commission power to make new rates effective as of a date earlier than the issuance of its order. Compare *Public Utils. Comm'n* v. *United Fuel Gas Co.*, 317 U.S. 456, 464 (1943); Compact, *supra* note 9, tit. II, art. XII, § 6(b). However, it is also true that the language used "is not necessarily retroactive. It is as apt in reference to the future as it is to the past." *Transcontinental & West. Air, Inc.* v. *CAB*, 83 U.S.App.D.C. 358, 360, 169 F.2d 893, 895 (1948), *aff'd* 336 U.S. 601 (1949). "Retroactivity, even where permissible, is not favored, except upon the clearest mandate," *Claridge Apts. Co.* v. *Comm'r*, 323 U.S. 141, 164 (1944), and in the situation here presented there is an "almost conclusive presumption against power to take retroactive action unless Congress plainly specifies such power," *Transcontinental & West. Air, Inc.* v. *CAB*, *supra*, 83 U.S.App.D.C. at 359, 169 F.2d at 894.

[94] *Trans World Airlines, Inc.* v. *CAB*, 336 U.S. 601, 605 (1949), *affirming Transcontinental & West. Air, Inc.* v. *CAB*, *supra* note 93. We are aware that in an analogous context language similar to that employed in § 6(a)(2) of the Compact has been construed to permit new rates to be made effective as of the date the application for a rate increase was filed. See *Trans World Airlines, Inc.* v. *CAB*, *supra*, 336 U.S. at 605; see also *United States* v. *New York Cent. R.R.*, 279 U.S. 73 (1929). However, the presumption against retroactivity was there found to be rebutted, to that extent by clear indications of legislative intent in the history of the Act, see *Trans World Airlines, Inc.* v. *CAB*, *supra*, 336 U.S. at 605; *Transcontinental & West. Air, Inc.* v. *CAB*, *supra* note 93, 83 U.S.App.D.C. at 359-60, 169 F.2d at 894-95, and we have been unable to discover any such expression of legislative

mission lacks power to enter a new rate order in this proceeding, and that a remand for further consideration is not called for.[95]

---

purpose to govern our resolution of the problem presented here. Moreover, there are important differences between mail pay regulation, involved in the above cases, and the setting of rates to be paid by the general public, see *Delta Air Lines* v. *CAB*, 108 U.S.App.D.C. 88, 90, 92, 280 F.2d 636, 638, 640, *cert. denied* 364 U.S. 870 (1960), which militate against giving to the language of § 6(a)(2) an interpretation similar to that accorded the statutory language involved in *Trans World Airlines, Inc.* v. *CAB, supra.* We also note that the Compact provides no mechanism whereby Commission power to adjust retroactively the rates charged to the busriding public could be made effective--as, for example, by permitting the higher fares sought by the carrier to go into effect immediately subject to a contingent obligation, secured by a bond, to refund any excess of fares collected over those ultimately found to be just and reasonable. See, *e.g.*, *Hope Natural Gas Co.* v. *FPC*, *supra* note 92, 196 F.2d at 805-06; *City of New Haven* v. *New Haven Water Co.*, 132 Conn. 496, 45 A.2d 831 (1946); *cf. Natural Gas Act* § 4(e), 15 U.S.C. § 717 c(e). Instead the Compact simply empowers the Commission to suspend the proposed tariff, and provides that the tariff shall "take effect" unless suspended, or at the termination of the suspension period. Compact, *supra* note 9, tit. II, art. XII, §§ 5(e), 6(a)(1), 6(a)(2); see *Hope Natural Gas Co.* v. *FPC, supra* note 92, 196 F.2d at 806-07. That no mechanism was provided for retroactive adjustment of rates may well reflect the different problem presented by bus riders on the one hand, and gas or electric customers on the other. Compare *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S. App. D.C. at 232-33, 318 F.2d at 203-04 with *Washington Gas Light Co.* v. *Baker,* 88 U.S. App. D.C. 115, 127, 188 F.2d 11, 23 (1950), *cert. denied* 340 U.S. 952 (1951). In this connection it is significant, we think, that in conferring power on the Commission to prescribe divisions, between carriers, of joint fares, the Compact expressly authorizes "the adjustment of divisions . . . from the date of filing the complaint or entry of the order of investigation, or such other date subsequent thereto as the Commission finds to be just, reasonable and equitable." Compact, *supra* note 9, tit. II, art. XII, § 7(c). Compare, Compact, *supra* note 9, tit. II, art. XII, § 6(a)(2); see note 93, *supra.*

[95] "Remand to the Commission, in the circumstances of this case, could not be to enable a rate order to be superimposed upon the old application...." *Washington Gas Light Co.* v. *Baker, supra* note 88, 90 U.S.App.D.C. at 104, 195 F.2d at 35; see *Bebchick* v. *Public*

With Orders Nos. 245 and 563 invalid and further remand now futile,[96] it follows that Transit must be compelled to make appropriate restitution for the increased fares it col-

---

Utils. Comm'n, supra note 15, 115 U.S.App.D.C. at 232-33, 318 F.2d at 203-04; see also *Wisconsin* v. *FPC*, 373 U.S. 294, 304-06 (1963).

[96] It is true that, were a remand here warranted for the purpose of enabling the Commission to enter a new rate order, and if the Commission's findings on remand encompassed an inquiry into conditions existing prior to the effective date of the new order, see *Atlantic Coast Line R.R.* v. *Florida*, 295 U.S. 301, 312 (1935), we might take such findings into account in determining the question of restitution for amounts collected under the prior, invalid order, *id.* at 316. And, were a remand to be ordered for such purpose, we might conceivably defer the question of restitution until such time as the Commission had entered its new order on remand. *United States* v. *Morgan, supra* note 82. But *cf. Chicago, M., St.P. & P.R. R.R.* v. *Illinois*, 356 U.S. 906 (1958); *United Gas Co.* v. *Callery Properties*, 382 U.S. 223, 229-30 (1965). However, in both *Morgan* and *Atlantic Coast Line* there existed an independent jurisdictional basis for remand to the Commission, and the only question was the effect which should be given by the Court to the findings and determination of the Commission or administrator pursuant to the remand. The administrator in *Morgan* "was free to make an order fixing rates for the future, and for that purpose or any other within the purview of the Act he is now free to determine a reasonable rate for the period antedating any order he may now make." 307 U.S. at 192. To say that a reviewing court may sometimes give some retroactive effect to the eventual Commission order which, in respect of the Commission's authority is prospective only, is not at all to say that a remand is appropriate when the Commission's action could have *no* prospective effect. *Cf. Montana-Dakota Utils. Co.* v. *Northwestern Pub. Serv. Comm'n*, 341 U.S. 246, 253-55 (1951); see note 95, *supra*. Moreover, it should be noted that in both *Morgan* and *Atlantic Coast Line* applicable statutory provisions, which have no equivalent in the Compact, *supra* note 9, expressly gave the administrator or Commission power to inquire into the past. See *Morgan* v. *United States, supra* note 82, 307 U.S. at 192 n. 3; *Natural Gas Pipeline Co.* v. *Harrington*, 246 F.2d 915, 916 (5th Cir. 1957), *cert. denied* 356 U.S. 957 (1958); see also *FPC* v. *Hope Natural Gas Co., supra* note 38, 320 U.S. at 618-19.

lected.[97] This conclusion is unaffected by the fact that we do not decide that the fares authorized are unjust or unreasonable as a matter of law. Our role as a reviewing court is not to make an independent determination as to whether fares fixed by the Commission are just and reasonable, but rather to insure that the Commission, in exercising its rate-making power, has acted rationally and lawfully. Our function is normally exhausted when we have determined that the Commission has respected procedural requirements, has made findings based on substantial evidence, and has applied the correct legal standards to its substantive deliberations.[98] Our task is likewise at an end when we have ascertained that the Commission has not done so.[99] In this

---

[97] *Bebchick* v. *Public Util. Comm'n, supra* note 94, 115 U.S.App. D.C. at 218-19, 232-33, 318 F.2d at 189-90, 203-04; *Washington Gas Light Co.* v. *Baker, supra* note 94, 88 U.S.App.D.C. at 127, 188 F.2d at 23. It is a principle, long established and of general application, that a party against whom an erroneous judgment or decree has been carried into effect is entitled, in the event of a reversal, to be restored by his adversary to that which he has lost thereby." *Arkadelphia Milling Co.* v. *St. Louis S.W. Ry.*, 249 U.S. 135, 145 (1919); *Baltimore & Ohio R.R.* v. *United States,* 279 U.S. 781, 785-86 (1929); *Atlantic Coast Line R.R.* v. *Florida, supra* note 96, 295 U.S. at 309. This principle is no less applicable to erroneous orders of an administrative agency than to those of a court. *United Gas Co.* v. *Mobile Gas. Co.*, 350 U.S. 332, 347 (1956); and see *Atlantic Coast Line R.R.* v. *Florida, supra,* 295 U.S. at 309-11.

[98] *ICC* v. *Hoboken Manufacturers' R.R.*, 320 U.S. 368, 381 (1943); *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); *Board of Trade* v. *United States,* 314 U.S. 534, 546 (1942); *Virginian Ry.* v. *United States,* 272 U.S. 658, 663 (1926); *State Corp. Comm'n of Kansas* v. *United States,* 184 F.Supp. 691, 696, 698 (D.Kan. 1959); *cf. Minneapolis & St. Louis Ry.* v. *United States,* 361 U.S. 173, 189, 194 (1959); *Gray* v. *Powell,* 314 U.S. 402, 412-13 (1941); *Moeller* v. *ICC,* 201 F.Supp. 583, 589 (S.D. Iowa (1962). See also *FPC* v. *Colorado-Interstate Gas Co.*, 348 U.S. 492, 501 (1955); *Crowell* v. *Benson,* 285 U.S. 22, 58 (1932).

[99] *Cf. Mountain States Tel. & Tel. Co.* v. *Public Serv. Comm'n, supra* note 87. There the utility had applied for a stay of a Commission order reducing intrastate telephone rates, which was granted on

case, given our conclusion that the Commission failed to apply appropriate criteria, and failed to make the inquiries prerequisite to valid exercise of its rate-setting authority, we could not permit Transit to retain the increased fares, since to do so would be to give legal effect to the Commission's invalid order.[100] This is so notwithstanding that we have

---

condition that the difference between existing rates and lower rates ordered by the Commission be impounded in a fund "until final decision in this case." When, after the order was set aside as arbitrary and remanded, the utility applied for release of the impounded funds, the court held in its favor, saying:

> "It is urged by the Commission that this court did not sustain the charges made by the utility pending review; that we in fact held that such charges were discriminatory. This position misconceives the function of this court in reviewing an order of the Commission. We, of course, in rendering our decision, acted within the scope of our authority. Consequently, we determined merely that the Commission had not regularly pursued its authority. Everything else stated in our opinion was in response to contentions of the plaintiff relative to confiscatory rates, arbitrary action by the Commission in respects other than those by us sustained, etc. But because we in the rationale of the opinion found that such contentions should be overruled, it does not follow that we determined that the rates charged by the utility were unjust, unreasonable or confiscatory. We did not so determine simply because that is not our function. Indeed, it is not a judicial function. It is legislative and is to be exercised by the arm of the legislature—the Public Service Commission." 155 P.2d at 187-88. See also *Cole* v. *Young*, 351 U.S. 536, 557 (1956).

[100] Until superseded by a valid order of the Commission, the rates on file prior to the application which preceded Order No. 245 were the only lawful rates. *United Gas Co.* v. *Mobile Gas Corp.*, *supra* note 97, 350 U.S. at 347; *Washington Gas Light Co.* v. *Baker*, *supra* note 94, in which the Commission's order granting a fare increase was set aside and restitution ordered, because, *inter alia*, it had "made no inquiry whatsoever into issues necessary to determination of a fair return," 88 U.S.App.D.C. at 20, 188 F.2d at 16; *Saturn Oil & Gas Co.* v. *Northern Natural Gas Co.*, 359 F.2d 297 (8th Cir. 1966); *Chicago, M., St.P. & P.R. R.R.* v. *Alouette Peat Products*, 253 F.2d 449 (9th Cir. 1957); *cf. Seatrain Lines* v. *United States*, *supra* note 86, 168 F.Supp. at 827-28; *Amarillo-Borger Express, Inc.* v. *United States*, 138 F.Supp. 411 (N.D. Tex. 1956), *vacated and remanded as moot* 352 U.S. 1028 (1957). See also *Natural Gas Pipeline Co.* v. *Harring-*

held neither that the Commission lacked power to order a fare increase, nor even that the fares authorized are, as a matter of law, unjust or unreasonable.[101]

Thus we are confronted with the necessity of formulating the criteria by which the amount of restitution is to be measured. Ordinarily, of course, the proper disposition on setting aside a rate increase unlawfully ordered by the Commission would be to compel the regulated company to restore the entire difference between the higher fares collected under the invalid order and the amount that it would have received from the fare schedule previously in effect.[102] More fundamentally, however, our decision in this regard is to be governed by the equitable considerations which apply to suits for restitution generally.[103] The basic question is whether "the money was obtained in such circumstances that the possessor will give offense to equity

---

ton, supra note 96. Some state courts have taken the view that the Commission-prescribed rates are conclusive during the period they are in effect, though later held to have been illegally established, if they are not stayed or suspended pending appeal. *Mandel Bros.* v. *Chicago Tunnel Terminal Co.*, 2 Ill.2d 205, 117 N.E.2d 774 (1954); *Keco Indus.* v. *Cinc. & Sub. Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465, *appeal dismissed, cert. denied* 350 U.S. 182 (1957). Compare *Gulf, C & S.F. Ry.* v. *American Sug. Ref. Co.*, 130 S.W.2d 1030 (Tex. Ct. Civ. App. 1939). Any such contention in this case is clearly foreclosed by our decision in *Bebchick* v. *Public Util. Comm'n, supra* note 94, 115 U.S.App.D.C. at 218-19, 232-33, 318 F.2d at 189-90, 203-04.

[101] "There is no reason under the Act why a shipper should not be protected in the situation here existing where the rates are unlawful because not lawfully established just as he is protected in the situation where the rates are unlawful because unreasonable. In either case, the protection is against unlawful rates." *Chicago, M., St.P. & P.R. Co.* v. *Alouette Peat Products, supra* note 100, 253 F.2d at 455.

[102] *Bebchick* v. *Public Util. Comm'n, supra* note 94; *Washington Gas Light Co.* v. *Baker, supra* note 94.

[103] *Atlantic Coast Line R.R.* v. *Florida, supra* note 97, 295 U.S. at 310.

and good conscience if permitted to retain it," and is "no longer whether the law would put him in possession of the money if the transaction were a new one."[104] Since restitution is not a matter of right, but is "*ex gratia*, resting in the exercise of a sound discretion,"[105] it lies within our authority to direct restitution in an amount less than the whole sum of the increased fares collected under the invalid order,[106] or to deny it altogether, if compelling equitable considerations so dictate.[107] The exercise of such an equit-

---

[104] *Ibid.*

[105] *Ibid.*, citing *Gould* v. *McFall*, 118 Pa.St. 455, 12 A. 336, 337 (1888).

[106] In *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 97, the Court denied restitution altogether, since the Commission on remand had reached the same result, this time on the basis of adequate findings, thus enabling the Court to perceive "that what was charged [under the original order] would have been lawful as well as fair if there had been no blunders of procedure, no administrative delays." 295 U.S. at 315. The Court recognized that there was "a possibility between ... [the] extremes [of granting restitution in whole or not at all], a possibility exemplified in the decree of the court below." *Id.* at 316-17. Though apparently not disapproving the District Court's disposition in principle, the Court observed that "the present record does not satisfy us that a new scale should be set up to govern claims for restitution." *Id.* at 317. The apparent reason for rejecting the District Court's solution was the availability of the Commission's later order which reaffirmed its original action on the basis of adequate findings and was thus entitled to "great respect." *Ibid.* In view of our disposition of Orders 245, 563 and 564, we are without the means to perceive the reasonableness of the fares collected during the period in question. See also notes 116, 117, *infra*, and accompanying text. Nevertheless, we see no obstacle to our permitting the company to retain some, though not all, of the proceeds of the fare increase if there is reliable evidence suggesting that it would be inequitable to compel restitution in a greater amount. "[R]estitution is granted to the extent and only to the extent that justice between the parties requires." *Restatement, Restitution*, ch. 8 at 596 (1937).

[107] *Blair* v. *Freeman*, 125 U.S.App.D.C. 207, 217-18, 370 F.2d 229, 239-40 (1966); see *United States* v. *Morgan*, *supra* note 82.

able discretion by this court is by no means an usurpation of the administrative powers of the Commission nor is it an arbitrary extension of judicial authority; it is "mere inaction and passivity in line with the historic attitude of courts of equity for centuries."[108]

Because we have found the Commission's action in approving the fare increase to have been invalid, and because we have no basis in later valid action of the Commission for inferring that the rates set by Order No. 245 were, in fact, just and reasonable, despite the defects in the Commission's deliberations leading to their original approval,[109] we could not, as we have said, give legal effect to those rates by withholding restitution altogether. At the same time, we are confronted by circumstances indicating a substantial probability that it would be inequitable to compel Transit to restore the entire amount it realized from the fare increase. More specifically, we see that by Order No. 245 the Commission found that the net income of $937,669 which Transit would earn under the then existing fare schedule would not constitute a "fair and adequate return,"[110] and nowhere in this proceeding has that finding been challenged. Indeed, the evidence presented by protestants at the 1963 hearing was to the effect that a return of $1,107,000 would be fair and reasonable.[111] Additionally, we note that the net income which the Commission found Transit would earn in consequence of the preexisting fares

---

[108] *Atlantic Coastline R.R.* v. *Florida, supra* note 97, 295 U.S. at 315.

[109] See note 106, *supra;* see also notes 116, 117, *infra,* and accompanying text.

[110] *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 408. Compare *Atlantic Coast Line R.R.* v. *Florida, supra* note 97, 295 U.S. at 313.

[111] See *In re D.C. Transit Sys., Inc.* (Order No. 563), *supra* note 10, 63 P.U.R.3d at 39.

would have represented a return on equity of less than 8%,[112] while protestants' expert witness recommended a return on equity of 12%.[113] And in a later rate proceeding, after determining Transit's cost of capital and taking into account the returns afforded by other companies of comparable risk, the Commission found to be fair and reasonable a return on equity of 14%,[114] a determination today affirmed by this court as based on adequate findings and reasons supported by substantial evidence.[115] We could not permit the Commission's latter conclusion to control the amount of restitution now to be ordered, since it was based on a record reflecting conditions in years later than the period relevant here,[116] and it did not purport to be a determination of a fair return for the years with which we are concerned.[117] On the other hand, it has obvious significance as a factor suggesting the inequity in ordering Transit to repay the entire amount of the fare increase.

In sum, we find substantial and unmistakable indications,

---

[112]This figure results from dividing the average book equity figure set by the protestants, see note 67, *supra* and accompanying text, by $937,669, see note 68, *supra* and accompanying text.

[113]See notes 44-47, *supra* and accompanying text.

[114]Order No. 684, *supra* note 34.

[115]*D.C. Transit Sys., Inc.* v. *Washington Metropolitan Area Transit Comm'n*, No. 21,029, *supra* note 90.

[116]In *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 97, 295 U.S. at 316, the Court noted that "nowhere in the record is there a suggestion on the part of any one that during this long litigation there has been any change of conditions. . . . What was injustice at the date of the second order of the Commission is shown beyond a doubt to have been injustice also at the first." In this case, involving the finances of a single company, we could not be certain "beyond a doubt" that conditions had not changed between 1963 and 1967. *Cf. Bell* v. *United States*, 49 F.Supp. 505, 508 (E.D. La. 1943).

[117]Compare *Atlantic Coast Line R.R.* v. *Florida*, *supra* note 97, 295 U.S. at 312-13.

in the record under review as well as in a subsequent determination of the Commission which we have affirmed, that it would be unfair to order Transit to restore the full amount it realized under the invalid fare increase. In so concluding, we have placed particular reliance upon the Commission's finding as to the amount of net income which would have been earned by Transit under the fare schedule in effect prior to Order No. 245. That finding was properly grounded, conformably with the Commission's role in fixing rates to operate in the future, upon estimates of expenses to be incurred and revenues to be received during the future test period. But we perceive no justification for permitting such a prediction to control the course we are to follow in equitably disposing of funds collected during years already past.[118] "There are times, to be sure, when resort to prophecy becomes inevitable in default of methods more precise. At such times, 'an honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances' is the only organon at hand. . . . But prophecy, however honest, is generally a poor substitute for experience."[119] We think these obser-

---

[118] *Cf. Wisconsin* v. *FPC*, *supra* note 95. There, proposed rate increases filed by the carrier pursuant to § 4(e) of the Natural Gas Act, 15 U.S.C. § 717c(e), had gone into effect at the end of the suspension period, subject to a refund obligation. These rate increases were later superseded, thus becoming "locked-in." The Commission terminated the § 4(e) proceedings, thus allowing the rate increases to remain effective during the "locked-in" period, when it found that the increased revenues generated by the higher fares had not been sufficient to cover the company's computed cost of service for the historical test period, and thus that no refunds were due. The Supreme Court affirmed, 373 U.S. at 304-06. See also *Michigan Wisconsin Pipe Line Co.* v. *FPC*, 263 F.2d 553, 555-56 (6th Cir. 1959).

[119] *West Ohio Gas Co.* v. *Public Utils. Comm'n*, 294 U.S. 79, 82 (1935); see *Trans World Airlines, Inc.* v. *CAB*, __ U.S.App.D.C. __, __, 385 F.2d 648, 656 (1967), *cert. denied* 36 U.S.L.W. 3346 (Mar. 5, 1968); *Summerfield* v. *CAB*, 92 U.S.App.D.C. 248, 252-53, 207 F.2d 200, 203-05 (1953), *aff'd sub nom. Western Airlines, Inc.* v. *CAB*, 347 U.S. 67 (1954).

vations are applicable here, and we are unable to see how any proper resolution of the matter of restitution in the circumstances presented could ignore the reality of Transit's financial experience during the years in question.[120]

In laying down a standard by which to measure Transit's right to retain funds collected under the fare increase, we are aware that we are ill-equipped, even were we authorized to do so, to search the record and reach our independent conclusions as to what would have constituted reasonable fares for the period in question. Nevertheless, the duty to reach a just decision in this regard cannot be shirked, and our effort must be to find a solution which lies within our competence as a reviewing court, while at the same time responding in the fullest possible measure to the equitable considerations that must guide us.

The disposition we deem most consonant with this objective would compel Transit to restore the amount realized by the fare increase only to the extent that its actual return is not reduced to an amount which all parties have agreed would be unreasonably low. Thus Transit will be permitted to retain any portion of the higher fares necessary to preserve its actual earnings during the years in question[121] at the level conceded by the protestants to represent a fair return. In so doing, we do not say that the Commission erred in failing to adopt the testimony of protestants' expert witness, nor that fares designed to produce the return proposed by the protestants would have been the

---

[120]See *Wisconsin* v. *FPC*, *supra* note 95; *Smith* v. *Illinois Bell Tel. Co.*, 282 U.S. 133, 142, 161-62 (1930); *Southwestern Bell Tel. Co.* v. *Kansas State Corp. Comm'n*, 53 P.U.R.3d 337 (Kan. Sup. Ct. 1964); *City of Pittsburgh* v. *Pennsylvania Pub. Utils. Comm'n*, 169 Pa. Super. 400, 82 A.2d 515, 519-20 (1951). But see *State Corp. Comm'n of Kansas* v. *FPC*, 215 F.2d 176, 183-84 (8th Cir. 1954).

[121]That is, the period during which Order No. 245, *In re D.C. Transit Sys., Inc.*, *supra* note 2, was in effect. See notes 90, 91, *supra*.

only lawful fares, nor even that they would have been just and reasonable. We decide only that in the circumstances of this case it clearly does not offend "equity and good conscience" to permit Transit to retain that part of the fare increase essential to avoidance of an undisputedly unfair return. One circumstance upon which we place considerable weight in reaching this conclusion is the availability of the Commission's 1967 decision permitting a return to the equity holder quite close to that recommended by the protestants in this proceeding.[122] Though, for reasons already explained, we are unable to regard that determination as controlling with respect to the question before us, we think it is entitled to weight as "the opinion of a body of experts upon matters within the range of their special knowledge and experience."[123] Being cognizant of the dangers in attributing finality to positions taken by the parties in a proceeding which so broadly affects the interests of the public as this one, we do not decide whether, in the absence of that later determination by the Commission, the course taken here would be open to us.

II

The Acquisition Adjustment Account

Petitioners in No. 20,201 complain of a fundamental change by the Commission in the method of its treatment of Transit's acquisition adjustment account, which has engaged our attention before.[124] The event giving rise to this account was Transit's purchase in 1956 of properties from its predecessor, Capital Transit Company (Capital), at

---

[122] *In re D.C. Transit Sys., Inc.* (Order No. 684), *supra* note 34; see text accompanying notes 114, 115, *supra.*

[123] *Atlantic Coast Line R.R.* v. *Florida, supra* note 96, 295 U.S. at 317.

[124] See *Transit I, supra* note 1, 121 U.S.App.D.C. at 390-91, 350 F.2d at 768-69; *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 220-221, 318 F.2d at 191-92.

a price lower by $10,339,041 than the net original cost of those properties to Capital.[125] Transit's allowances for depreciation thereon could, of course, have been related to its own acquisition cost; but this would have required the development of new depreciation rates computed on remaining life, and new depreciation bases derived in part from distribution of the purchase price among the items of property acquired. To save the labor incidental to that process, however, the Public Utilities Commission of the District of Columbia (PUC), the Commission's predecessor, ordered that two things be done. One was the establishment of the acquisition adjustment account to accommodate an amortization, over a ten-year period beginning August 15, 1956, of the $10,339,041 difference in acquisition cost to Capital and Transit, respectively.[126] The other was a direction that depreciation be accrued on the basis of Capital's original cost and at the rates previously fixed for Capital, with ten annual offsetting credits to operating expenses of $1,033,904 derived from the amortization.[127]

PUC selected the ten-year period for amortization in order to link it to an annual accrual of $1,044,196 over the identical period to a reserve designed to absorb Transit's estimated future expenses for track removal and street repaving incidental to its franchise-required conversion from Capital's trolley-bus operation to Transit's eventual all-bus

---

[125] See *Transit I, supra* note 1, 121 U.S.App.D.C. at 390-91, 350 F.2d at 768-69; *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 220-21, 318 F.2d at 191-92.

[126] *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 394; Order No. 3592 (unreported) (PUC 1957), quoted in *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 394. See also *Transit I, supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768; *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 220-21, 318 F.2d at 191-92.

[127] *Transit I, supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768; *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 220-21, 318 F.2d at 191-92.

operation.[128] With the amortization and the accrual in almost the same annual amount for exactly the same period, any material impact from either upon Transit's income posture would be avoided.[129]

In Order No. 245, however, the Commission suspended the annual accruals to the reserve as of January 1, 1963, concluding that its existing balance would cover all of Transit's removal and repaving expenses anticipated for the immediate future.[130] The Commission stated that it would also reexamine the period for liquidation of the acquisition adjustment balance in light of PUC's decision to coincide its amortization with the period established for accruals to the reserve for removal and repaving.[131] The Commission observed that "the proper [original] solution [by PUC], completely equitable to both applicant and the ratepayers, would have required the total sum represented by the acquisition adjustment account to be distributed 'over all items of depreciable property' as recorded on the books as of August 15, 1956,"[132] and it felt that such treatment "would have been the only completely accurate and equitable method."[133] The Commission would, it said, "relate the acquisition adjustment balance to the properties acquired on August 15, 1956, which are still in service and subject to depreciation at original cost"[134] but, noting that addi-

---

[128] *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 394.

[129] See Franchise Act § 7, 70 Stat. 598 (1956). See also *Transit I*, *supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768; *Bebchick v. Public Utils. Comm'n*, *supra* note 15, 115 U.S.App.D.C. at 220-21, 318 F.2d at 191-92.

[130] *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 395-97.

[131] *Id.* at 395.

[132] *Id.* at 394.

[133] *Ibid.*

[134] *Id.* at 395.

tional evidence was needed for this purpose, it ordered that amortization of the acquisition adjustment account continue without change "until adequate evidence supporting a different rate [of amortization] is presented to the commission."[135]

In *Transit I*, we upheld the Commission's determination on this point.[136] Shortly before we did so, however, the Commission, by Order No. 385, had proceeded to alter radically the scheme for amortization of the acquisition adjustment balance.[137] Without taking further evidence, it decided that as of January 1, 1964, the period for amortization of the balance of $2,519,484[138] would be extended to August 15, 1976, the duration of Transit's franchise.[139] The Commission thus enlarged the remaining original period, which would have expired on August 15, 1966, for the write-off of this balance from approximately two and one-half years to about twelve and one-half years, and reduced the amount of the annual amortization from the previous $1,033,904 to the much lower figure of $199,561.[140]

In directing this change, the Commission did not relate the liquidation of the acquisition adjustment balance to any

---

[135] *Ibid.*

[136] 121 U.S.App.D.C. at 390-91, 350 F.2d at 768-69.

[137] Order No. 385 (unreported) (WMATC 1964).

[138] Order No. 385 stated that the then balance of $2,713,484 was subject to an adjustment of $194,539 for a tax settlement and other costs related to the acquisition agreement, leaving $2,519,458 to be amortized.

[139] Order No. 385 (unreported) (WMATC 1964).

[140] After tax adjustments to the acquisition adjustment account, its annual amortization figure under the original ten-year plan would have been $959,793 through August 15, 1966. In consequence of the Commission's change, the amount of the annual amortization became $199,561. *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 49.

new schedule for depreciation of the involved properties, a procedure it had promised in Order No. 245 and one which we had regarded as "most sensible."[141] Instead, it said that amortization of that balance within the remaining two and one-half years of the period originally prescribed might so reduce net operating profits after the terminal point on August 15, 1966 as to require another fare increase.[142] Thus arising is the question whether the Commission was at liberty to alter the mode of amortization, with a view to pegging Transit's fares, without correlating in some reasonable fashion, the new method in time and amount to ongoing depreciation of the acquired properties, for the inflated book values of which the acquisition adjustment account was established as an offset.

As a preliminary matter, though, we face, but reject, a common protest by Transit and the Commission that petitioners are foreclosed from litigating that issue because they did not seek a review of Order No. 385, by which the change complained of was directed. The Commission promulgated Order No. 385 without a hearing of any sort, in spite of its claim, in defending its earlier Order No. 245 before us in *Transit I*, that it had to have more evidence before it could intelligently alter the amortization of the acquisition adjustment balance.[143] And when the Commission adopted Order No. 385, it proceeded upon a completely new theory—the need to stabilize Transit's fares. There was no opportunity for the protestants to combat the change, or the basis upon which it was made, before it became a reality.

Petitioners made a timely application to the Commission for reconsideration of Order No. 385. In denying it, the Commission proclaimed that the order was "subject to com-

---

[141] *Transit I, supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768.

[142] Order No. 385 (unreported) (WMATC 1964).

[143] *Transit I, supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768.

plete analysis and review in any future rate proceeding."[144] This very clearly left the matter open to reexamination, and indeed the Commission reexamined it in Order No. 564, this time rejecting petitioners' objection on the merits.[145] It is the determination made in the latter order, presently under review, that petitioners now attack, and this they may properly do.

Reverting to the merits of petitioners' contention, we find that the Commission's new plan for amortization of the acquisition adjustment balance largely sets for naught fundamental considerations the Commission was obliged to observe. One was the intended function of the amortization as the counterweight to excessive depreciation charges. While, on the assets Transit bought from Capital, Transit was annually taking the same depreciation Capital was allowed to take, the amount of the annual amortization was to balance out the difference between Transit's purchase price and their higher value on Capital's books.[146] Quite obviously, Transit's annual depreciation expense would become inflated if the compensatory value of the amortization was reduced. And such a reduction was necessarily destined when the Commission ordered its drastic changes in the amortization term and the amount of the annual amortization.

This we see in vivid outline as we again consult the record before us. Of $46,534,172 in original cost of the depreciable properties Transit acquired from Capital in 1956,

---

[144] Order No. 406 (unreported) (WMATC 1964).

[145] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 49-50. And see *Jason* v. *Summerfield*, 94 U.S.App. D.C. 197, 199-200, 214 F.2d 273, 275-76, *cert. denied* 348 U.S. 840 (1954); *Niagara Mohawk Power Corp.* v. *FPC*, 91 U.S.App.D.C. 395, 402, 202 F.2d 190, 198 (1952), *aff'd* 347 U.S. 239 (1954); *Churchill Tabernacle* v. *FCC*, 81 U.S.App.D.C. 411, 413, 160 F.2d 244, 246 (1947).

[146] See the text *supra* at notes 126 and 127.

a total of $35,979,793, or 77.3% had been retired from service by January 1, 1964, the effective date of the Commission's change.[147] By Transit's projection, not significantly variant from the plan the Commission adopted in Order No. 385,[148] 61.1% of the remaining $10,554,379 would be retired at the close of 1966, the future test period, and 89.3% thereof at the end of 1970—approximately the midpoint of the new amortization period.[149] At the same time, the acquisition adjustment amortizations, which would occur annually in level amounts, would quite expectably maintain a steady course. The ever-growing divergence of property retirements from acquisition adjustment amortization[150] is

---

[147]By January 1, 1964, the original acquisition adjustment balance of $10,339,041 had been reduced to $2,519,484. Thus 24.4% of the balance remained unamortized, while 22.7% of the acquired depreciable properties were still in service. And see note 148, *infra*. It is interesting to note that while the original amortization term was fixed to coincide with the ten-year period for accruals to the track removal and street repaving reserve, the unamortized acquisition adjustment balance, on the date of changeover to the new plan, was fairly close to what it would have been had the amortization been tied entirely to the depreciable lives of the acquired assets.

[148]The acquisition adjustment balance on January 1, 1964, was $2,344,990 according to Transit, but $2,519,484 according to the Commission. And while Transit's calculation would have reduced the annual amortization to $193,011, the figure the Commission arrived at was $199,561.

[149]The service lifetimes of certain of Transit's properties extend beyond the term of its franchise, while the Commission's change compresses the amortization within the remaining period of the franchise. But according to the testimony of Transit's vice president and comptroller, this factor would make the percentages we recite only "slightly higher" than they would otherwise be.

[150]This divergence would have been avoided had the Commission adopted the procedure recommended by its staff. In Order No. 385 the Commission said:

> "The Commission staff has related the balance in the Acquisition Adjustment Account to the properties acquired on August 15, 1956, which are still in service and subject to depreciation at their original cost. The staff then projected retirement

revealed in the following computation:[151]

	At The End Of		
	1963	1966	1970
Unretired Properties	22.7%	8.8%	2.4%
Unamortized Acquisition Adjustment Balance	24.4%	18.6%	10.8%

The Commission's stated reason for modification of the acquisition adjustment amortization was the avoidance of a fare increase in 1966, when under the existing arrangement the amortization would come to an end.[152] Nonetheless, it did not undertake to support, either by evidence or findings,[153] its theory that this circumstance would create a probable need for such an increase, and on the record its view in that regard seems conjectural. This is especially so since at the time of the changeover there existed a court-ordered reserve of more than $2,000,000 to serve precisely the Commission's professed purpose.[154] And we detect, as serious consequences of the Commission's modification of the acquisition adjustment amortization, artificial reductions

---

dates for these properties and calculated an amortization schedule based on such projections, cutting off at August 15, 1976, as the expiration date of the franchise. This produced an uneven and constantly reducing amount of amortization per year; it also would be subject to change as projected retirements materialized earlier or later than scheduled. These characteristics are the major disadvantages of this plan of amortization; they could be avoided, and the recurring credits smoothed out, if the amortization were placed on a straight-line basis."

[151] This is our computation based, of course, upon the record data. And see note 149, *supra*.

[152] Order No. 385 (unreported) (WMATC 1964).

[153] See note 86, *supra*, and accompanying text.

[154] See the text at note 15, *supra*, and notes 190 to 195, *infra*.

of Transit's net earnings for ensuing years which ostensibly would justify the very fare increase that the change was predicted to forestall.

For the calendar year 1964, Transit stated a return on equity of 10.56%, reflecting $511,115 in net income and $4,837,992 in equity. Without the change, Transit's net income would have been $760,232 greater,[155] and the return on equity would have soared to more than 26%. Similarly, for the 12 months ending June 30, 1965—the historical test period[156]—Transit reported net operating income of $1,024,855, representing a 3.23% rate of return; but without the change the return on equity, with another $760,232 in additional income for that year,[157] the rate of return would have been almost 75% greater. Again, for 1966—the future test period[158]—Transit's net earnings were estimated at only $648,357,[159] but with the change its projected depreciation expense was $475,145 higher than otherwise it would have been.[160]

Judicial decisions have long censured depreciation plans breeding excessive charges which in turn exaggerate the

---

[155]The $760,232 is the difference between $959,793 (the original $1,033,904 as adjusted by Order No. 385), which would have been the amount of annual amortization under the old ten-year plan, and $199,561, which was the figure under the new plan. See the text *supra* at note 140.

[156]See note 7, *supra*.

[157]See note 155, *supra*.

[158]See note 7, *supra*.

[159]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 58.

[160]The $475,145 is the $760,232 difference between old and new annual amortization amounts, see note 155, *supra*, for the seven and one-half months of 1966 to August 15 of that year when the old ten-year period would have expired.

costs of serving the public.[161] We ourselves have held, in a conceptually indistinguishable situation, "that the substantial inflation of operating costs due to excessive depreciation . . . is unlawful."[162] The Commission's handling of Transit's acquisition adjustment account does violence to the wholesome principle those cases espouse.

Moreover, the costs of the service a regulated utility provides should, as far as possible, be borne by those who are served as they are being served. The disproportion between the amortization of the acquisition adjustment balance and remaining depreciable life of the acquired properties charges present riders with substantial depreciation expense properly assignable only to those who will ride in the future. If Transit's customers are to pay for the rides they themselves take, operating expenses must be projected within a range that is reasonable in the historical as well as the mathematical sense.

We do not suggest that Transit should be required to make up at one fell swoop the differences reflected by possible percentage variations between the amount of depreciation accruing on the acquired properties before January 1, 1964, the Commission's changeover date, and the portion of

---

[161] See *FPC* v. *Natural Gas Pipeline Co., supra* note 98, 315 U.S. at 592-93, 594; *Dayton Power & Light Co.* v. *Public Utils. Comm'n,* 292 U.S. 290, 303-05 (1934); *Lindheimer* v. *Illinois Bell Tel. Co.,* 292 U.S. 151, 167-69, 174-75 (1934); *Clark's Ferry Co.* v. *Public Serv. Comm'n,* 291 U.S. 227, 239 (1934); *Smith* v. *Illinois Bell Tel. Co., supra* note 120, 282 U.S. at 158; *United Rys. & Elec. Co.* v. *West,* 280 U.S. 234, 254 (1930), *disapproved on another point FPC* v. *Hope Natural Gas Co., supra* note 38, 320 U.S. at 606-07; *Kansas City So. Ry.* v. *United States,* 231 U.S. 423, 446 (1913) quoting *Illinois Cent. R.R.* v. *ICC,* 206 U.S. 441, 462 (1907); *City of Knoxville* v. *Knoxville Water Co.,* 212 U.S. 1, 13-15 (1909).

[162] *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App. D.C. at 224, 318 F.2d at 195. See also *Washington Gas Light Co.* v. *Baker, supra* note 94, 88 U.S.App.D.C. at 121-126, 188 F.2d at 17-22.

the acquisition adjustment balance written off before that date.[163] Prior to that time, the period for amortization of that balance was related, not firmly to depreciable life of the properties Transit got from Capital, but rather, as we have said,[164] to the ten-year period for accruals to the reserve for track removal and street repaving; and this arrangement has never been challenged. The resolution of any problem in that connection is in the first instance, of course, a matter for the Commission. Now, however, the track removal and repaving accruals have been halted, at least temporarily, and the Commission has decided that it will put the amortization of the remaining acquisition adjustment balance on a different footing. We hold that, in doing so, it must maintain, subsequent to the changeover date, a reasonable relationship between the amortization and accruals of depreciation of the properties remaining in service.

III

Deficiency In Depreciation Reserve

In 1964, the Commission found a large deficiency, existing as of August 15, 1963, in Transit's reserve for depreciation on operating properties.[165] It then required the depreciation reserve to be adjusted upward to its proper level and, as an offset, the amount of the deficiency to be placed in a suspense account.[166] In Order No. 564, the Commission decided to close out the deficiency balance of $1,099,627 in the latter account.[167] The blueprint it followed in doing

---

[163]See note 147, *supra*.

[164]See the text accompanying notes 125 to 127, *supra*.

[165]Order No. 381 (unreported) (WMATC Sept. 11, 1964). After reducing the reserve by $580,658 to reflect the removal of obsolete equipment from Transit's accounts, the amount of the deficiency was fixed at $1,223,099.

[166]Order No. 381 (unreported) (WMATC Sept. 11, 1964).

[167]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12,

so, however, gave rise to the cluster of problems we reach next.

Of the deficiency balance, $806,168 was the aggregate of underaccruals of depreciation on properties then still in service. The Commission directed that this amount be taken out of the suspense account and placed above the line[168] in Transit's depreciation expense account for 1966[169] and treating that much of the deficiency as a decrement Transit might legitimately recover from its farepayers, the Commission granted Transit "[r]estoration" by authorizing the removal of $806,168 from the court-ordered reserve[170] that we have mentioned[171] and will shortly consider in greater detail.[172]

The remaining $293,459 of the deficiency balance represented underaccruals on properties which, after the deficiency was ascertained, were transferred to nonoperating status. Holding that Transit could not collect that portion of the deficiency from its farepayers, the Commission decreed that it be transferred from the suspense account to the depreciation expense account as a below-the-line[173] entry.[174]

---

63 P.U.R.3d at 56-57. The suspense account balance had declined from its original size, see *supra* note 165, as a result of salvage credits. *Id.* at 56.

[168]An entry "above the line" classifies a current revenue or expense item, and thus affects profit or loss. An entry "below the line" classifies a nonrecurring revenue or expense item, and thus effects only a capital adjustment.

[169]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 57.

[170]*Id.* at 68.

[171]See the text *supra* at note 15.

[172]See the text *infra* at notes 190 to 199.

[173]See note 168, *supra.*

[174]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 57.

The $806,168 Deficiency

Petitioners in No. 20,201 argue that the $806,168 should not have been charged off in a single year, and should not have been deducted from the court-ordered reserve. They point to the fact that some of the properties as to which this part of the deficiency arose have service lives exceeding 30 years, and urge that any recoupment be effected through annual deductions from operating income over the remaining life of Transit's franchise.

The problem, as we analyze it, breaks down into three facets, each of which we will discuss. The first concerns the handling of this item in the projection of Transit's operating costs preliminarily to establishment of a margin of return. The second is the question whether Transit may reclaim this portion of the under-accrued depreciation for its investors. If so, the third is whether its deduction from the court-ordered reserve, in lieu of some other type of adjustment, is in order.

—Treatment for Ratemaking Purposes

The Commission viewed the $806,168 as a loss to Transit's investors for which they had not been compensated, and felt that "the techniques of preferring to accomplish [reimbursement] by a charge against a court-ordered reserve in lieu of charging a particular period's profit and loss account, is merely a matter of semantics."[175] By its appraisal, "whether the deficiency . . . is written off directly on the operating statement of a particular period or periods, or whether it flows first through the court-ordered reserve, the impact on the ratepaying public is still the same."[176]

We are not able to concur in the Commission's reasoning. As we interpret the record, the above-the-line debit of the

---

[175] *Id.* at 57.

[176] *Ibid.*

$806,168 to Transit's depreciation expense account added just that much in pre-1966 depreciation expense to Transit's operating costs for 1966. The calendar year 1966, it will be recalled, was the future annual period for which Transit's operating expenses were estimated,[177] and we understand that the Commission's estimates incorporated this adjustment.[178] If this is so, the projection of depreciation expense was inflated to the extent of $806,168 by a past, nonrecurring item. This, in turn, would necessarily misshape the margin of return that Transit was ultimately allowed.

We have, in another context, delineated the principle that, to avoid this very kind of distortion, deductions for depreciation must be maintained in reasonable relationship with the service period of the property depreciated.[179] To reach the closest possible accord with that principle, depreciation deficiencies, once ascertained, must ordinarily be amortized over such remaining life as the properties involved may happen to have.[180] We speak now of the treatment of the $806,168 for ratemaking purposes, and not of its possible defrayal by Transit's riders. In the understanding that the Commission included that part of the depreciation deficiency in its computation of Transit's expenses for the future test period, we say that its action in doing so was erroneous.

---

[177] See note 7, *supra*.

[178] The Commission describes its findings "in relation to the operating forecast projected for 1966" as "incorporating all of the foregoing adjustments," *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 58, and included in those adjustments are those pertaining to the depreciation deficiency.

[179] See the text accompanying note 161, *supra*.

[180] See *In re Alpena Power Co.*, 85 P.U.R. (n.s.) 89, 91-92 (Mich. 1950); *In re Narragansett Elec. Co.*, 21 P.U.R.3d 113, 133-34 (R.I. 1957). See also *Pacific Tel. & Tel. Co.*, 5 P.U.R.3d 396, 415-18 (Cal. 1954); *In re Michigan Consol. Gas Co.*, 9 P.U.R.3d 433, 440-42 (Mich. 1955).

–Recovery from Farepayers

Petitioners do not contend that a depreciation deficiency cannot normally be levied against ratepayers, but encompassed, we think, within their objection to deduction of the $806,168 from the court-ordered reserve is the query whether Transit's farepayers now have such an obligation.[181]

---

[181] Judicial review of a Commission order is conditioned upon presentation to and determination by the Commission of an application for reconsideration. Compact, *supra* note 9, tit. II, art. XII, § 16. The application must "stat[e] specifically the errors claimed as grounds for such reconsideration," and "[n]o person shall in any court urge or rely on any ground not so set forth in such application." *Ibid.* See also *United States* v. *L.A. Tucker Lines, Inc.*, 344 U.S. 33, 36-37 (1952); *Unemployment Compensation Comm'n* v. *Aragon*, 329 U.S. 143, 155 (1946).

Petitioners' application for reconsideration of Order No. 564, which was denied, alleged error, *inter alia*, in the Commission's direction "that $806,168 be removed from the Court Ordered Reserve to restore the deficiency in the depreciation reserve." As do the parties, we deem the claim of error to have been asserted administratively in suitable procedural form, compare *United States* v. *Great Northern Ry.*, 343 U.S. 562, 567 n. 3 (1952); *Baltimore & O. R.R.* v. *United States*, 298 U.S. 349, 369-72 (1936), and to have been fittingly brought here by an incorporating reference in the petition for review and by reiteration in the parties' prehearing stipulation of the issues we are to decide. *Cf. Helvering* v. *Fuller*, 310 U.S. 69, 76 (1940).

This error, we believe, was identified with requisite specificity and yet its assignment was broad enough to challenge the propriety of the charge to farepayers of any portion whatsoever of the deficiency. *Cf. FPC* v. *Colorado-Interstate Gas Co.*, *supra* note 98, 348 U.S. at 497-99; *Halsted* v. *SEC*, 86 U.S.App.D.C. 352, 361-62, 182 F.2d 660, 669-70, *cert. denied* 340 U.S. 834 (1950). Moreover, petitioners would not, in their endeavors to support any ground submitted for the Commission's reconsideration, be confined to precisely the same reasons or argument advanced before the Commission, see *Dewey* v. *Des Moines*, 173 U.S. 193, 197 (1899); *Chase Nat. Bank* v. *United States*, 116 F.2d 625, 627-28 (2d Cir. 1940), and by the same token we would not be either.

In any event, Order No. 564 must be remanded to the Commission anyway, see pt. VIII, *infra*, whereupon the justice of assessing any of the deficiency to the farepayers can be fully restudied. That question

It was "clear to the Commission that this deficiency in depreciation charges should equitably be made up by charges to the ratepayer,"[182] but to us that is not nearly so evident. We would agree that if Transit's investors have not recouped the portion of their investment reflected by the deficiency, the Commission, weighing the equities, might in some reasonable manner impose some or all of the burden upon the riders.[183] We encounter difficulty, however, because although the Commission undertook to determine whether the burden should "equitably" fall upon investors or farepayers, it nowhere appears to have ascertained whether Transit's investors have already been reimbursed for the diminished value of their investment.

We faced a cognate problem in *Washington Gas Light Company* v. *Baker*,[184] where PUC, in fixing the utility's rate

---

touches the public at large, and the Commission should look beyond the immediate concerns of the parties to the more general welfare, even in situations, more exaggerated than that here, where those who might have objected remained completely silent. Indeed, "[t]here may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider questions of law which were neither pressed nor passed upon by the court or administrative agency below." *Hormel* v. *Helvering*, 312 U.S. 552, 557 (1941). See also *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 239 (1940); *United States* v. *Atkinson*, 297 U.S. 157, 160 (1936). We deem it appropriate here to discuss the principle which should guide the Commission on remand in ascertaining where the burden of the deficiency should equitably rest. Compare *Coffey* v. *Jordan*, 107 U.S.App.D.C. 113, 114-15, 275 F.2d 1, 2-3 (1959); *Ward* v. *Anderson*, 93 U.S.App.D.C. 156, 158-59, 208 F.2d 48, 50 (1953).

[182] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 57.

[183] "If the factual premise is true, that is, if past earnings were not sufficient to compensate investors for inadequate depreciation charges, then the Commission may properly require the burden to be borne by consumers or to be shared by investors and consumers depending upon the circumstances." *Washington Gas Light Co.* v. *Baker*, *supra* note 94, 88 U.S.App.D.C. at 125, 188 F.2d at 21.

[184] *Supra* note 94.

base, deducted an allocable portion of its book reserve for depreciation rather than straight-line depreciation accruals. PUC acted upon the conclusion that the utility's revenues had been reduced because the annual charges for depreciation during most of the life of the property were too low, and that "it would be inequitable for investors to bear the burden a second time by, for example, charging the undepreciated amount to earned surplus."[185] We pointed out that

> "Despite this premise, the record contains no evidence as to whether earnings during the life of this property sufficiently exceeded the fair rate of return to compensate investors for the inadequate depreciation charges. We recognize that the legality of past rates may not be challenged, and that past excessive earnings belong to the Company just as past losses must be borne by it. That is not to say, however, that when the Commission purports to act on the equities of the situation, and awards higher rates because of past inequities to investors, it must not support the factual premise upon which it builds by evidence in the record. 'Elaborate calculations which are at war with realities are of no avail.' "[186]

The same considerations are involved here. The Commission made no finding as to whether Transit's investors have received remuneration for the depreciation undercharges from actual earnings over and above fair return while the properties were in service.[187] Nor has our attention been directed to any evidence upon which a considered judgment in that regard could be attained.[188] We cannot

---

[185] 88 U.S.App.D.C. at 125. 188 F.2d at 21.

[186] *Id.* at 125, 188 F.2d at 21, quoting *Lindheimer* v. *Illinois Bell Tel. Co.*, *supra* note 161, 292 U.S. at 164.

[187] See note 86, *supra*, and accompanying text.

[188] In Order No. 245, the Commission examined the returns earned by Transit and its predecessor companies over a 28-year period for purposes of determining whether Transit's investors had been compensated for assuming the risk of obsolescence of abandoned rail properties. In the Commission's view "the returns earned [during this period] were generally below the rates of return established as being

approve as equitable an arrangement based upon a determination that does not reflect a consideration of factors crucial to an informed decision as to where the equities really lie. Our remand of Order No. 564 will provide an opportunity for the Commission to explore the matter, make findings, and reach a just conclusion responsive to the guidelines we have discussed.[189]

–Resort To The Court-Ordered Reserve

Should the Commission find that Transit's investors remain unreimbursed for the underaccrued depreciation, it would again face the question whether repayment could be

---

reasonable by the regulatory body" and "the regulatory authority, in fixing the rates of return . . ., did not allow any additional compensation for the risk of obsolescence." *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 402. We affirmed the Commission in that respect. *Transit I, supra* note 1, 121 U.S.App.D.C. at 395 n. 47, 350 F.2d at 773 n. 47. We cannot regard the circumstance that the returns earned over a 28-year period were "generally below" the levels administratively fixed as reasonable, as a demonstration that, during the particular periods the properties insufficiently depreciated were in service, there were no excesses of earnings over fair returns as would wholly or partially provide reimbursement for the depreciation deficiency.

[189] As we have observed, see *supra* note 165, some of the depreciation deficiency represented obsolete equipment that was eliminated from Transit's accounts. In *Washington Gas Light Co.* v. *Baker, supra* note 94, 88 U.S.App.D.C. at 123, 188 F.2d at 19, we pointed out that "[i]t . . . becomes relevant to determine whether or not investors have, during the useful life of [abandoned] property, been compensated for assuming the risk that it would become inadequate or obsolete before the investment in it was entirely recovered." See also *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 224, 318 F.2d at 195. It may be that in this case the investors have not been so reimbursed. See note 188, *supra*, and compare note 167, *supra*. The evidence, however, is hazy in this respect, and in any event "[t]hat is an inquiry which must be made in the first instance by the Commission." *Washington Gas Light Co.* v. *Baker, supra* note 94, 88 U.S.App.D.C. at 124, 318 F.2d at 20. This the Commission must do following our remand.

accomplished by resort to the court-ordered reserve—a course petitioners vigorously oppose. We reiterate, however, that the $806,168 represented depreciation accruing during an era gone by, and that to no extent was it an advance charge for depreciation to arise only in the future. And we rule that the court-ordered reserve is a legitimate source for full and immediate rectification of any unreimbursed deficiency that might be found.

In our 1963 *Bebchick* decision,[190] we held that a fare increase PUC had granted Transit was unwarranted, and this made necessary a disposition of the excess in fares that Transit had collected while the increase was in effect. It was "not feasible," we said, "to require refunds to be made to individuals who paid the increase,"[191] but "[n]evertheless, the amount realized by Transit from the increase must be utilized for the benefit of the class who paid it, that is, those who use Transit."[192] To accomplish this, we continued Transit must establish a fund, or set up an account or reserve, in an amount equal to the increase.[193] We specified that "[t]he utilization and disposition of the fund, or the special account or reserve, as the case may be, shall be left to the discretion of the Commission having regulatory authority with respect to Transit, provided such discretion is exercised consistently with the purpose of benefiting Transit users in any rate proceedings pending or hereafter instituted."[194] Thus the special reserve, to which the Commission within these limitations was at liberty to resort, soon thereafter came into being.[195]

---

[190] *Bebchick* v. *Public Utils. Comm'n*, *supra* note 15.

[191] *Id.* at 232, 318 F.2d at 203.

[192] *Ibid.*

[193] *Id.* at 232-33, 318 F.2d at 203-04.

[194] *Id.* at 233, 318 F.2d at 204.

[195] The $2,350,000 credit in the reserve included $1,318,612 required by our supplemental opinion in *Bebchick* v. *Public Utils. Comm'n*, *supra* note 15, 115 U.S.App.D.C. at 232-33, 318 F.2d at

The deficiency in Transit's depreciation reserve developed because too little depreciation had been charged to farepayers in 1963 and prior years.[196] The Commission, in correcting the deficiency of $806,168 from the court-ordered reserve, endeavored to place the charge, as nearly as could be, where it should always have been. As the Commission said, "[t]he logic of charging this deficiency off against the court-ordered reserve lies in the fact that just as the credits in the court-ordered reserve represent a build-up over a period of years prior to the current year, so does the depreciation reserve deficiency represent a build-up in past years' depreciation charges to be made up in current or future periods."[197]

In sum, the court-ordered reserve is the equivalent of fare overpayments, and the deficiency is the amount of depreciation undercharges, both occurring in the past. The Commission's conclusion, in essence, was that the past depreciation undercharges might be offset by the past fare overcharges.[198] The objectives the reserve was designed to achieve, we think, are well served by its use to make Transit whole for any unredeemed diminution in value of its properties devoted to past public use, in lieu of the imposition of that burden on future farepayers. We would regard such a procedure as a proper exercise of the Com-

---

203-04. The remainder reflected a settlement by the parties of litigation involving the Commission's intervening rate Order No. 4735 (1961) mentioned in that opinion. The reserve credit was created by reductions of $500,000 in Transit's earned surplus, $1,000,000 in its depreciation reserve, and $850,000 in the reserve for track removal and repaving. *Bebchick* v. *Public Utils. Comm'n*, Civil No. 1529-60 (D.D.C. Sept. 10, 1963).

[196] Compare the text accompanying note 197, *infra*.

[197] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 57.

[198] Compare *Dayton Power & Light Co.* v. *Public Utils. Comm'n*, *supra* note 161, 292 U.S. at 305.

mission's regulatory discretion,[199] provided only that Transit's investors have not already received adequate recompense.

The $252,688 Deficiency

As we have observed,[200] the Commission directed that $293,459 of the total depreciation deficiency be charged below the line to Transit's depreciation account for nonoperating properties, thereby foreclosing its recapture from the farepayers. Transit concedes that this was proper as to $40,771, which relates to properties never placed in public use,[201] but contests the disposition of the remaining $252,688, asserting that the latter was a recoverable depreciation deficiency on operating properties.

The $252,688 is unreimbursed depreciation accumulating on a garage and on an office building while in public service during the period in which the general depreciation underaccrual occurred. After the deficiency was discovered by the Commission in 1964 and its amount was ascertained, the garage in its entirety and the office building to the extent of 80% were transferred to nonoperating status and removed from public use.

The sole reason the Commission advanced for the adjudication complained of was that because these properties were no longer in public service at the time the Commission decided to close out the depreciation suspense account, they should assume their aliquot share of the deficiency.[202]

---

[199] This we say in full realization that the Commission, in administering the court-ordered reserve, acts more nearly as a trustee to implement judicial directives concerning the use of the fund than in the exercise of its statutory regulatory powers. See the text accompanying note 194, *supra*.

[200] See the text *supra* at notes 173 and 174.

[201] These properties were limousines which, though operating properties, were not and are not devoted to public use.

[202] "The commission, after considering all the testimony on the subject in this case, agrees with the logic and the conclusion that $293,459

This conclusion, we hold, is erroneous as a matter of law. Indisputably, $252,688 of the deficiency was attributable to the garage and the office building at a time when they were fully operative and wholly devoted to public service. Like unrecovered depreciation accruing on other properties while so engaged,[203] Transit was entitled to reimbursement of the $252,688 from its farepayers. There is no disabling connection between a deficiency in past years' depreciation and the fact that the property giving rise to it is subsequently withdrawn from public use. The charge for depreciation is generated while the property is consigned to the public weal, and is not eroded by what is done with it thereafter.

The Commission must therefore give the deficiency of $252,688 the same treatment that the $806,168 will be accorded. This means that the Commission, after thorough investigation, will first determine the extent, if any, to which Transit's investors may have already been repaid by excesses of past actual earnings over a fair margin of return while the properties in question were in service.[204] The Commission will then proceed to a disposition consonant with justice to all concerned.

IV

The Investment Tax Credit

Transit has benefited considerably from the investment credit, since 1962 permitted against federal income taxes,[205] including a credit estimated at $685,608 for the test year

---

of this deficiency would be shared by the buildings which contributed to this deficiency, and which have, since August 15, 1963, been placed below the line." *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 57.

[203] See the cases cited *supra* note 180.

[204] See the text *supra* at notes 184 to 189.

[205] 26 U.S.C. §§ 38, 46-48.

1966.[206] The Commission did not, either for that year or for any prior period, utilize the credit to reduce its rate-making projections of Transit's total tax expense. Petitioners in No. 20,201 complain that, as a result, these savings have never been passed on to Transit's riders, and that this in effect has required the riders to pay for taxes greater than those Transit has actually incurred. Transit should be required, these petitioners urge, to transmit the credit to its customers through the medium of lower fares.

Order No. 564 tells us that the Commission's treatment of Transit's investment credits is an effort "to comply with the intent of Congress as expressed in Section 203(e) of the 1964 [Internal] Revenue Act."[207] That section restates the congressional purpose, in making the credit available, "to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated)."[208] It further provides, germanely to the issue here, that "Congress does not intend that any agency or

---

[206] Transit used investment credits of $117,843 for 1962, $123,667 for 1963, and $90,640 for 1964. No credit was expected to be used for 1965 because a loss from operations was anticipated. For 1966, the credit to be generated during that year, together with a carry-forward available from previous years, gave Transit an estimated total credit of $685,608.

[207] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 58. The Commission added, however, that "any benefits flowing to Transit from these investment tax credits will not be ignored by the Commission in any cash flow considerations." *Ibid.*

[208] "It was the intent of Congress in providing an investment credit under Section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use–

"(1) in the case of public utility property (as defined in section 46(c) (3) (B) of the Internal Revenue Code of 1954), more than

instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the consent of the taxpayer, use" the credit "to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method."[209] We have already had occasion to analyze the requirement Section 203(e) imposes, and to apply it with full force to a federal regulatory agency.[210]

The Commission's discussion of the problem leaves us uncertain as to whether it considers itself controlled by Section 203(e), or as to whether the Commission adheres to it as a matter of administrative policy. The section in terms applies only to an "agency or instrumentality of the United States,"[211] which the Commission clearly is not. It is the creature of the Compact[212] made by the District of Columbia and the states of Virginia and Maryland, to which Congress of constitutional necessity consented,[213] consolidating the Washington metropolitan area for unitary

---

a proportionate part (determined with reference to the average useful life of the property with respect to which the credit was allowed) of the credit against tax allowed for any taxable year by section 38 of such Code or

"(2) in the case of any other property, any credit against tax allowed by section 38 of such Code,

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method." 26 U.S.C.A. § 38 note, "Treatment of Investment Credit by Federal Regulatory Agencies."

[209] *Ibid.* No "public utility property," within the meaning of Section 203(e), see note 208, *supra*, is involved here because the quoted term does not include property used in furnishing a passenger transportation service. 26 U.S.C. § 46(c) (3) (B).

[210] *North Cent. Airlines* v. *CAB*, 124 U.S.App.D.C. 251, 363 F.2d 983 (1966). See also *Trans World Airlines* v. *CAB*, *supra* note 119, __ U.S.App.D.C. at __, 385 F.2d at 668.

[211] *Supra* note 208.

[212] *Supra* note 9.

[213] 74 Stat. 1031 (1960), D.C. Code § 1-1410 (1967 ed.); 76 Stat. 765 (1962), D.C. Code § 1-1410a (1967 ed.).

regulation of mass transit service. Congress contemplated that the Commission would be "the common agency of the signatories,"[214] and the Compact designates the Commission "an instrumentality of" the three contracting powers,[215] a character inevitable from numerous provisions it contains.[216] The Commission was in error if it felt that it was inexorably bound by the injunction Section 203(e) imposes.[217]

But the issue does not vanish here, for the Commission's authority to administratively adopt the canon expressed in Section 203(e) is something else again. "A regulatory agency," we have said, "may, should, and in some instances must, give consideration to objectives expressed by Congress in other legislation, assuming they can be related to the objectives of the statute administered by the agency."[218]

---

[214] 74 Stat. 1031 (1960), preamble.

[215] Compact, *supra* note 9, tit. I, art. II.

[216] Prominent examples are: The Commission is composed of three members, one of whom is appointed by the chief executive authority of each signatory from the agency of that signatory having jurisdiction over the regulation of mass transit within its borders. Tit. I, art. III, § 1. The Commission's expenses are borne by the three signatories. Tit. I, art. IV. The signatories by their joint action, may amend the Compact without prior congressional approval, and the amendment is effective unless within one year thereof it is disapproved by Congress. Tit. I, art. IX, § 1. Any signatory may withdraw, and thereby terminate the Compact, upon one year's written notice to the other signatories. Tit. I, art. IX, § 2.

[217] Compare *DeVeau* v. *Braisted*, 363 U.S. 144 (1959); *Petty* v. *Tennessee-Missouri Bridge Comm'n*, 359 U.S. 275 (1959); *Bell* v. *Waterfront Comm'n*, 279 F.2d 853 (2d Cir. 1960); *Rivoli Trucking Corp.* v. *American Export Lines*, 167 F.Supp. 937, 939 (E.D.N.Y. 1958); *Bolger* v. *United States*, 189 F.Supp. 237, 256 (S.D.N.Y. 1960), *rev'd on other grounds sub nom. Cleary* v. *Bolger*, 371 U.S. 392 (1963). See also *Miller* v. *City of Greenville*, 138 F.2d 712, 717-18 (8th Cir. 1943); *Pearl* v. *United States*, 230 F.2d 243, 244-45 (10th Cir. 1956).

[218] *City of Chicago* v. *FPC*, __ U.S.App.D.C. __, 385 F.2d 629, 635 (1967).

It may, in an appropriate exercise of the authority delegated to it, select adjudicative guidelines from policy incorporated into statutes not legally binding upon it.[219]

It does not, however, appear that the Commission, in adhering to Section 203(e), engaged in a decisional act. Administrative discretion implies concentration upon a problem in its distinctive context, while legislation must necessarily address the problem more broadly. What in overall result may be wholesome as a legislative rule having general operation may be unfeasible as a judgmental exercise in a particular case. The Commission's consideration of Transit's investment credits embraced only a reference to the statute, with which it coupled "an effort to comply with the intent of Congress as expressed in" the statute,[220] without any indication that it was making either a conscious choice or an individualized application of the statutory rule as a rule of its own. Moreover, it seems to have made no appraisal as to the desirability of applying the Section 203(e) requirement in the situation before it, or effort to balance an inducement to Transit to invest against the possibility of lower rates to the traveling public.

In sum, there are no signs of the particularized inquiries or the reasoned conclusions which make for an exercise of discretion. On the contrary, the Commission states that its disposition of the matter "is in accordance with commission

---

[219]See *Minneapolis & St. L. Ry.* v. *United States, supra* note 98, 361 U.S. at 186; *United States* v. *Radio Corp. of America,* 358 U.S. 334, 351-52 (1959); *FCC* v. *RCA Communications, Inc.,* 346 U.S. 86 (1953); *McLean Trucking Co.* v. *United States,* 321 U.S. 67, 79-80 (1944); *National Broadcasting Co.* v. *United States,* 319 U.S. 190, 222-24 (1943); *Southern S.S. Co.* v. *NLRB,* 316 U.S. 31, 47 (1942); *City of Chicago* v. *FPC, supra* note 218, 385 F.2d at 635; *City of Pittsburgh* v. *FPC,* 99 U.S.App.D.C. 113, 126, 237 F.2d 741, 754 (1956); *City of Detroit* v. *FPC,* 97 U.S.App.D.C. 260, 272, 230 F.2d 810, 822 (1955), *cert. denied* 352 U.S. 829 (1956). *Cf. Trans World Airlines* v. *CAB, supra* note 119, 385 F.2d at 668.

[220]See the text *supra* at note 207.

action in rate cases which were processed through this commission since the 1964 [Internal] Revenue Act was passed,"[221] and that "[t]he commission finds no reason at this juncture to change its policy with respect to treatment of the investment tax credit."[222] This plainly connotes an undeviating course pursued with reference to every carrier in every Commission proceeding, irrespective of its individual and perhaps unique characteristics.

This case is essentially not unlike *FCC* v. *RCA Communications, Inc.*,[223] where the commission involved, because of the "national policy in favor of competition,"[224] authorized an applicant to furnish radiotelegraph service to two foreign countries in duplication of a similar service already afforded by another company. The Court pointed out that "[t]he Commission has not in this case clearly indicated even that its own experience, entirely apart from the tangible demonstration of benefit for which [the other company] contends, leads it to conclude that competition is here desirable. It seems to have relied almost entirely on its interpretation of national policy."[225] The Court said that "[h]ad the Commission clearly indicated that it relied on its own evaluation of the needs of the industry rather than on what it deemed a national policy, its order would have a different foundation"[226] but, it added, "[t]o say that national policy without more suffices for authorization of a competing carrier wherever competition is reasonably feasible would authorize

---

[221] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 58.

[222] *Ibid.*

[223] *Supra* note 219. See also the opinion following remand, 99 U.S.App.D.C. 163, 238 F.2d 24 (1956).

[224] *FCC* v. *RCA Communications, Inc.*, *supra* note 219, 346 U.S. at 89.

[225] *Id.* at 91.

[226] *Id.* at 94.

the Commission to abdicate what would seem to us one of the primary duties imposed on it by Congress."[227] In the Court's view, it was "not inadmissible for the Commission, when it makes manifest that in so doing it is conscientiously exercising the discretion given it by Congress, to reach a conclusion whereby authorizations would be granted wherever competition is reasonably feasible."[228] But the Commission's grant, it was held, was infirm because "the conclusion was not based on the Commission's own judgment but rather on the unjustified assumption that it was Congress' judgment that such authorizations are desirable."[229]

We think substantially similar considerations obtain in this case, and conclude that we should remand to the Commission for inquiry and deliberation suitable to proper treatment of Transit's investment credits. Legislative policy reflected in tax statutes of general application may have a legitimate role in rate regulation, and tax objectives may be honored in a degree appropriate within the principles mandated by the specific regulatory statute drawn into the litigation.[230] This is particularly so when, as here, it is evident that without regulatory consequences the tax program may encounter frustration.[231]

---

[227] *Id.* at 95.

[228] *Id.* at 96.

[229] *Ibid.* The Court had previously stated that "[t]hat there is a national policy favoring competition cannot be maintained today without careful qualification," *id.* at 91, while the congressional policy behind Section 203(e) is clear, see *supra* note 207 and accompanying text. We do not consider this difference a distinguishing factor insofar as the Commission's duty to use its own discretion is concerned.

[230] *City of Chicago* v. *FPC*, *supra* note 218, 385 F.2d at 635-38; *Alabama-Tennessee Natural Gas Co.* v. *FPC*, 359 F.2d 318, 331, 335 (5th Cir.), *cert. denied* 385 U.S. 847 (1966). See also *Panhandle Eastern Pipe Line Co.* v. *FPC*, 115 U.S.App.D.C. 8, 11-12, 316 F.2d 659, 662-63 (*en banc*), *cert. denied* 375 U.S. 881 (1963); *City of Detroit* v. *FPC*, *supra* note 219, 97 U.S.App.D.C. at 271-72, 230 F.2d at 821-22.

[231] See *North Cent. Airlines* v. *CAB*, *supra* note 210, 124 U.S.App. D.C. at 253, 363 F.2d at 985.

The congressional goal in making the investment credit available is crystal clear. The committee reports on the 1962 legislation—which gave birth to this credit—stated in unison that the aim was to stimulate investment by reducing the net cost of acquiring depreciable assets.[232] "Realistic depreciation alone, however," the Senate Committee on Finance explained, "is not enough to provide the essential economic growth. In addition, a specific incentive must be provided if a higher rate of growth is to be achieved."[233] And while, save as a reflector of legislative policy, Section 203(e) does not itself concern the Commission, the fact remains that Transit, in common with other taxpayers, was made a beneficiary of the investment credit by the 1962 provisions. Neither in purpose nor in substance were the latter affected in their bearing upon nonfederally regulated utilities by the circumstance that the Section 203(e) compulsions were limited to federal regulatory agencies.

On the other side of the ledger is the admonition that "when the out-of-pocket tax cost of the regulated [taxpayer] is reduced, there is an immediate confrontation with the ratemaking principle that limits cost of service to expenses actually incurred."[234] Deviations from that guideline can be tolerated only when solidly justified upon "a delicate balancing by the Commission of the interests of the company, its shareholders, the consumer, and the pub-

---

[232] S. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962); H.R. Rep. No. 1447, 87th Cong., 2d Sess. 8 (1962); H.R. Rep. No. 2508, 87th Cong., 2d Sess. 14 (1962). See also H.R. Rep. No. 749, 88th Cong., 1st Sess. 36 (1963); S. Rep. No. 830, 88th Cong., 2d Sess. 42 (1964).

[233] S. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962) (emphasis added). *North Cent. Airlines* v. *CAB, supra* note 210, 124 U.S.App. D.C. at 253, 363 F.2d at 985.

[234] *FPC* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 244 (1967). See also *City of Chicago* v. *FPC, supra* note 218, 385 F.2d at 633, quoting *In re United Fuel Gas Co.*, 12 F.P.C. 251, 265 (1953); *Trans World Airlines* v. *CAB, supra* note 119, 385 F.2d at 668.

lic."[235] In our view, congressional objectives underlying both the tax and the regulatory laws here involved would be subserved by Transit's retention of so much, but no more, of its investment credits as would provide sufficient incentive for outlays in depreciable properties on a scale and at a pace beneficial to the traveling public.[236] This will, of course, involve a careful assessment of the extent, if any, to which Transit, as a regulated carrier, needs the inspiration the investment credit is designed to furnish and, if so, the treatment essential to meeting that need.[237] The pre-

---

[235] *Panhandle Eastern Pipe Line Co.* v. *FPC*, 113 U.S.App.D.C. 94, 97, 305 F.2d 763, 766 (1962), *cert. denied* 372 U.S. 916 (1963). As we have had occasion to say, "[t]ax statutes are not decisive as to the administration of other Government programs," *Trans World Airlines* v. *CAB*, *supra* note 119, 385 F.2d at 666, and "[w]hat Congress provides in a tax statute does not necessarily control in the implementation of federal regulatory statutes." *City of Chicago* v. *FPC*, *supra* note 218, 385 F.2d at 635. See *FPC* v. *United Gas Pipe Line Co.*, *supra* note 234; *Alabama-Tennessee Natural Gas Co.* v. *FPC*, *supra* note 230, 359 F.2d at 335; *El Paso Natural Gas Co.* v. *FPC*, 281 F.2d 567, 573 (5th Cir. 1960), *cert. denied* 366 U.S. 912 (1961).

[236] Compare *Panhandle Eastern Pipe Line Co.* v. *FPC*, *supra* note 230, 115 U.S.App.D.C. at 11, 12, 316 F.2d at 662, 663; *City of Detroit* v. *FPC*, *supra* note 219, 97 U.S.App.D.C. at 271-72, 230 F.2d at 821-22; *Alabama-Tennessee Natural Gas Co.* v. *FPC*, *supra* note 230, 359 F.2d at 331.

[237] Though unsure as to whether Section 203(e) applied to it, the Public Service Commission of the District of Columbia quite recently has passed the investment credit on to consumers. *In re Potomac Elec. Power Co.*, 64 P.U.R.3d 364, 370-73 (1966).

Many state regulatory commissions considering the impact of Section 203(e) upon ratemaking, before and after its amendment in 1964, have passed on to the consuming public, in one form or another, all or part of the credit.

Some commissions have adopted the "flow through" principle to benefit customers immediately through lowered expenses. *Pacific Tel. & Tel. Co.* v. *California Public Utils. Comm'n*, 44 Cal.Rptr. 1, 401 P.2d 353, 375-77 (1965); *In re Torrington Water Co.*, 48 P.U.R.3d 1, 5 (Conn. 1963); *In re New Jersey Water Co.*, 51 P.U.R.3d 224, 235-36 (N.J. 1963); *In re Consolidated Edison Co.*, 56 P.U.R.3d 337, 366-

cise point at which relevant tax policy and ratemaking principles may become reconciled is primarily a matter of administrative expertise and judgment, subject to judicial appraisal by the standards traditionally governing review of administrative action.[238] But any play the Commission might give to Section 203(e) requirements can be indulged solely in consequence of an exercise of its own judgment,[239]

---

68 (N.Y. 1964); *In re Chillicothe Tel. Co.*, 60 P.U.R.3d 270, 274-76 (Ohio 1965); *In re Manchester Water Co.*, 61 P.U.R.3d 295, 299-300 (Vt. 1965).

Other commissions have subscribed to a method by which customers realize the saving over the depreciable life of the properties that made the investment credit possible. *City of Pittsburgh* v. *Pennsylvania Public Utils. Comm'n*, 208 Pa.Super. 260, 222 A.2d 395, 402-03 (1965); *In re Indiana Water Corp.*, 50 P.U.R.3d 87, 90 (Ind. 1963); *In re Citizens Tel. Co.*, 57 P.U.R.3d 73, 78 (Ky. 1964); *In re Accounting Procedure for Investment Tax Credit*, 61 P.U.R.3d 256, 261-63 (Mich. 1965); *Pennsylvania Public Utils. Comm'n* v. *Columbia Gas Co., Inc.*, 60 P.U.R.3d 385, 413-14 (Pa. 1965); *In re Inter-Mountain Tel. Co.*, 59 P.U.R.3d 337, 342-43 (Tenn. 1965); *In re Kansas-Nebraska Natural Gas Co.*, 54 P.U.R.3d 184, 193-95 (Wyo. 1964).

At least one commission has held that while the investment credit could not reduce the utility's tax expense, it would lower its rate base harmoniously with the smaller net cost of the acquisition. *In re Otter Tail Power Co.*, 49 P.U.R.3d 305, 311 n. 3 (N.D. 1963). In *City of Pittsburgh* v. *Pennsylvania Public Utils. Comm'n, supra*, the court upheld the Commission's decision both to pass on the amortized portion of the tax credit in the form of lower expenses and to reduce the rate base in the amount of the unamortized portion.

[238] *City of Chicago* v. *FPC, supra* note 218, 385 F.2d at 636; *Cities of Lexington, etc.* v. *FPC*, 295 F.2d 109, 114 (4th Cir. 1961); *Alabama-Tennessee Natural Gas Co.* v. *FPC, supra* note 230, 359 F.2d at 330. See also *Panhandle Eastern Pipe Line Co.* v. *FPC, supra* note 230, 115 U.S.App.D.C. at 12, 316 F.2d at 663.

[239] See *FPC* v. *United Gas Pipe Line Co., supra* note 234; *Minneapolis & St. L. Ry.* v. *United States, supra* note 98, 361 U.S. at 186-87; *FCC* v. *RCA Communications, Inc., supra* note 219; *McLean Trucking Co.* v. *United States, supra* note 221, 321 U.S. at 85-88. Compare *City of Chicago* v. *FPC, supra* note 218, 385 F.2d at 635-36; *Trans World Airlines* v. *CAB, supra* note 119, 385 F.2d at 666-68; *Panhandle*

soundly conceived and exercised with appropriate regard for the responsibilities entrusted to it, and our approval will be summoned only by a rational accommodation of the investment credit within the Commission's positive duty to maintain the reasonableness of Transit's fares.

V

Deferred Tax Charges on Track Removal and Street Repaving Costs

From August, 1956, through the calendar year 1962, as we have mentioned in another context,[240] Transit accrued $1,044,196 annually to its reserve for track removal and street repaving, but during the same period spent substantially less for these purposes.[241] In the computation of its District of Columbia income taxes,[242] Transit was allowed deductions, not for amounts accrued, but only for removal and repaving costs actually incurred during the tax year.[243] The ratemaking treatment warranted in this situation thus became a problem confronting Transit's regulatory agencies.

In 1959, PUC ordered the resulting increases in Transit's income taxes to be charged to the reserve for removal and repaving, attributing this technique to a net-of-taxes theory.[244] The underlying idea was that there would be

---

Eastern Pipe Line Co. v. *FPC*, *supra* note 230; *FCC* v. *RCA Communications, Inc.*, 99 U.S.App.D.C. 163, 238 F.2d 24 (1956), *cert. denied* 352 U.S. 1004 (1957).

[240] See the text *supra* at notes 128 to 130.

[241] As of December 31, 1962, $6,656,748 has been accrued to the account and $1,842,499 expended therefrom. *In re D.C. Transit Sys., Inc.* (Order No. 245), *supra* note 2, 48 P.U.R.3d at 395-96.

[242] D.C. Code § 47-1571a (1967 ed.).

[243] This problem did not arise with respect to Transit's federal income taxes. In that connection, Transit employed the accrual method to deduct from its taxable income the amount of the annual increment to the reserve for track removal and street repaving.

[244] Order No. 3592 (unreported) (PUC 1959).

charges to the reserve, instead of to income tax expense, for the higher taxes in the earlier years when accruals exceeded expenses; and that these charges would be offset, in the later years when taxes would decrease as actual expenses surpassed accruals, with credits to the reserve matched and corresponding debits to income tax expenses. Thus, said PUC, "the customers will not be currently charged with the total estimated cost of track removal and repaving without the offsetting benefit of the related reduction in income taxes."[245] By mid-1965, in consequence of this process, the reserve had been reduced by $222,072 in accumulated tax charges.[246]

In the meanwhile, after the Commission suspended accruals to the reserve in 1963,[247] Transit's track removal and street repaving expenses became substantial. By Order No. 564, the Commission directed Transit to remove the $222,072 from the reserve by a credit in that amount to the reserve and a contra-debit to a new account denominated "Deferred Tax Charges–Track Removal Costs."[248] The Commission stated that this adjustment "was made to conform with the 'net of taxes' treatment instituted by" PUC,[249] explaining that "[i]f the charges to the [reserve] account were generated on a 'net of taxes' basis, and continued thus over a 7-year period as long as debt adjustments were required, consistency demands that, now that the time has arrived for the credit entries, the procedure set up by the PUC be continued to its logical conclusion."[250] The

---

[245] *Ibid.*, quoted in *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 51.

[246] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 50.

[247] See the text *supra* at note 130.

[248] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 50.

[249] *Ibid.*

[250] *Ibid.*

Commission then made provision for a new charge, as an operating expense for 1963 and the first eight months of 1964, of 5% of Transit's net cost of track removal and repaving.[251] The Commission also made known its plan to "continue the entire 'net of taxes' treatment of track removal expenditures until the entire amount of $222,072.22 is offset."[252]

Transit's prime objection to this procedure stems from apprehensions that it will reduce its recovery of the increased income taxes it was required to pay to the District. After the Commission stopped accruals to the reserve for track removal and repaving, Transit's annual expenditures for track removal and repaving rose to a point higher than its annual District taxable income.[253] Since the District makes no provision for carrying tax losses forward, Transit urges that it will be permanently deprived of at least some of the tax decreases in later years that, on a net-of-taxes basis, would ordinarily have approximated the earlier tax elevations. Transit also argues that by directing the 5% charge as an annual operating expense, the Commission has departed from the net-of-taxes approach in seeking to make Transit whole.

We find Transit's fears to be unfounded, and its criticisms of the Commission's program unavailing. The Commission fully recognized that the increased income taxes Transit has been required to pay to the District, as well as all its expenses for track removal and street repaving,[254]

---

[251] *Ibid.*

[252] *Ibid.*

[253] By Transit's computation, its expenses in removing tracks and repaving streets exceeded its District of Columbia taxable income (before such charges) by $537,927 in 1963 and $541,784 in 1964, and an excess of $1,086,258 was estimated for 1965.

[254] Compare *Bebchick* v. *Public Utils. Comm'n*, *supra* note 15, 115 U.S.App.D.C. at 220-23, 318 F.2d at 191-94; *Transit I*, *supra* note 1, 121 U.S.App.D.C. at 390, 350 F.2d at 768.

are ultimately to be charged to its fare-payers. The Commission's order, as elucidated by an elaborate interpretive representation,[255] in practical effect simply defers the charges for taxes to such times as expenditures are made from the reserve. The burden of the charges will eventually fall upon the farepayers, and Transit's reimbursement therefor will sooner or later become complete. We need not ponder whether, consistently with law and with sound ratemaking and accounting principles, the Commission might have dealt with the problem differently.[256]

---

[255] In its brief, the Commission states comprehensively the construction it intended for Order No. 564 in this respect:

> "The Commission has at no time made any assumptions as to the relationship between taxable income on a District of Columbia tax return and the amount of expenditure for track removal. . . . The Commission arrived at its decision with a clear understanding of the fact that taxes which had to be paid by the Company at the time of accrual were being deferred on a net-of-taxes basis and that this deferral had to be offset at the time of actual expenditure and deduction from the Company's District of Columbia income tax return. This is what the Commission order proposes. Fulfillment of the order will result in the removal of the deferred tax as expenditures are made. This will permit the $222,000 to be charged to the ratepayer, if, as, and when the expenditures, for which accruals had been made in the Reserve for Track Removal, materialize. . . .
>
> "The ratepayer will be charged directly for the tax as and when the Company expends the money that has been accrued for this track removal purpose. This is true even though in some years the expenditures will exceed the taxable income of the Company on its District of Columbia tax return. The order of the Commission was devised to overcome the difficulty that might otherwise have been faced in clearing out the deferred income tax. The order of the Commission ignores the relationship between the Taxable income on the District of Columbia tax return and the amount expended for track removal, with the express purpose of making certain that as expenditures are made, the deferred tax is plowed back as an expense to the ratepayer."

[256] See *Mitchell* v. *Budd*, 350 U.S. 473, 480 (1956); *SEC* v. *Chenery Corp.*, 332 U.S. 194, 207-09 (1947); *Cardillo* v. *Liberty Mut. Ins. Co.*, 330 U.S. 469, 477-78 (1947).

Nor need we join in the debate between Transit and the Commission as to whether its treatment accords *with* the original net-of-taxes theory, to which the Commission in any event was not legally wedded.[257] It was clearly within the Commission's authority and discretion to relate Transit's recovery of the tax increases to its actual expenditures from the reserve,[258] and we decline to upset on grounds of unreasonableness the method by which it does so.

VI

Estimate of Bus Maintenance

Transit projected the expenses[259] associated with the operation of its buses by adding to its actual operational costs of $4,249,452 during the historical test period ending June 30, 1965, the increases, computed on a system-wide basis,[260] which it anticipated for 1966, the future test period. The Commission, however, adopted the estimate of its staff, which was lower by $426,538.[261] This difference was attributable to a decrease in expenses which the staff

---

[257] Compare the cases cited in note 145, *supra*.

[258] Compare the theory underlying the principles discussed in the text *supra* at notes 160 to 162, 179 to 180. See also the cases cited in note 252, *supra*.

[259] These costs embraced fuel, lubricants, tires, and chassis and body maintenance for Transit's fleet of 1202 buses as of June 30, 1965.

[260] Thus Transit's statistical factor, hereinafter referred to, is the system cost per mile, derived by dividing the total maintenance cost of all buses, regardless of group, by total miles of operation, regardless of group. Compare the Commission's group method of computation, described in the text *infra* at notes 262 and 263.

[261] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 55. The difference between Transit's and the staff's respective estimates, as made, was $574,578. Transit's projection, however, took account of an estimated increase of $148,040 in maintenance payroll, an item the staff treated separately. Thus the net difference between the two estimates was $426,538.

expected as a result of Transit's programmed replacement of 100 old buses with new buses in June, 1965, and a turnover of another 100 buses in June, 1966.

The Commission's staff accepted, as the cornerstone of its projection, Transit's historical cost figure of $4,249,452. It began its calculation of adjustments for the future by estimating the number of miles buses in each of various groups[262] would travel during 1966, and multiplying those miles by a per-mile cost of operation for that group. It then worked into its computation the 200 new buses, assigning to each a maintenance cost factor, throughout 1966, of six cents per mile of operation, exclusive of increased labor costs for 1966; and eliminated the 200 oldest buses in Transit's fleet, which were much more expensive to maintain.[263] This substitutional technique won the approval of the Commission, which deemed it "[t]he most important adjustment" that Transit should have made.[264]

This observation, to say the least, is not fully accurate. Transit's appraisal of future expenses, as we have pointed out,[265] incorporated bodily its expenditures for bus maintenance during the historical test year expiring in June 30, 1965. Since the beginning of 1962, when Transit became fully converted to an all-bus system, it has acquired an average of about 115 new buses each year, and has removed from service an equivalent number of its older buses; and from 1958 until 1962, it had similarly replaced 75 to 100 buses per year. Thus Transit's actual maintenance expense

---

[262] Each group consisted of buses of the same model acquired by Transit at the same time.

[263] The staff substituted the 200 new buses for 142 in-service buses with an estimated 1965 maintenance cost of 26.05 cents per mile, and 58 other in-service buses with an estimated 1965 maintenance cost of 15.31 cents per mile.

[264] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 55.

[265] See the text *supra* at note 260.

for the historical test year, which the Commission's staff accepted and utilized,[266] included and gave full credit to the savings realized from the exchange during that year of approximately the same number of new buses which would displace old buses during 1966, the future test year. From aught that appears, the staff's appraisal in some measure—perhaps in large part—duplicated this reduction,[267] and concomitantly lowered the amount purporting to reflect Transit's overall bus maintenance expense for the future.

But this is not all. The evidence vindicates Transit's thesis that operational expenses become larger as a bus grows older, and obviously a new bus placed in service in mid-1965 or mid-1966 will be months older at the end of 1966.[268] Since the staff's rating for the maintenance of the 200 new buses was an unchanging factor of six cents per mile throughout 1966, the increased cost of operation that accompanies aging was not given its just due.[269]

---

[266] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 55.

[267] It is not for us, at least in the first instance, to measure the extent of the duplication. We recognize, however, that this would depend partly upon how closely operating costs of buses retired during the historical test period compared with the costs of those the Commission's staff eliminated for the future annual period, see note 263 *supra*, and partly upon the degree of coincidence in the number of buses involved in each period. We observe only that, in consequence of the circumstances recited in the text, some duplication was inevitable.

We also note, in this connection, the average age of Transit's buses is steadily decreasing as a result of the annual infusion of new vehicles. Transit figures denote a reduction from 9.41 years in 1962 to 6.94 at the end of 1965.

[268] Related to this point is other evidence to the effect that the per-mile cost of operation goes up as the number of miles a bus operates comes down, and that reduced mileage usually accompanies aging.

[269] An expert testified that the staff "used figures that showed these trends [that increased maintenance expense accompanies aging] right up to the year ending June 30th, [1965,] but somehow, by putting some water in the radiators from the 'fountain of Youth,' [it]

Moreover, the staff's estimate of six cents, the record reveals, was derived from Transit's operation of 20 brand-new buses over a period during 1965 of less than a month.[270] A cost history of the operation of so few new buses for so short a time affords a dubious statistical base for projecting the maintenance expense for as many as 200 buses in periods ranging from six to 18 months.[271] Moreover, the staff's six-cents factor was overwhelmingly contradicted by Transit's experience data fixing a significantly higher figure.[272]

---

managed to stop all that, [it] then went right on through eighteen months without a change."

[270]The staff took from Transit's records a per-mile cost of 5.14 cents for operation of these 20 buses, but this was for operation over only 23,000 miles at the very beginning of service when costs are lowest. With this as its base, the staff raised its estimate to six cents flat, exclusive of labor increases in 1966. But compare the data in notes 271 and 272, *infra*.

[271]By the staff's plan, 100 of the new buses would travel a total of 4,098,030 miles throughout the full calendar year 1966, and these would be 18 months old at the end of the period; and the other 100 buses would travel a total of 2,040,973 throughout the last six months of 1966, and these would be six months old at the end of the period.

[272]By October 30, 1965, actual maintenance costs on the new buses delivered during the previous June and July—and these were buses the staff estimated six cents per mile would maintain—had already risen to 7.65 cents per mile. As a matter of long experience, Transit's maintenance costs on new buses during the first year's operation have varied between seven and eight cents per mile at times when labor costs were substantially less than in 1966.

From January 1, 1962, when Transit began an all-bus operation, through June 30, 1965, its system cost per mile, see note 260, *supra*, ranged from a low of 13.31 cents in 1964 to a high of 13.93 cents in 1962, and was 13.23 cents for the six months ending June 30, 1965. During this period, the system cost per mile decreased an aggregate of 7/10 of a cent, the largest reduction in any year being 4/10 of a cent in 1963. The staff's estimate of six cents per mile, converted to Transit's system cost per mile, would multiply these decreases, as appears from the next paragraph.

As we have said, see the text *supra* at notes 262 and 263, the staff computed Transit's bus maintenance cost per mile of operation

Still another problem springs from the manner in which the Commission's staff, preliminarily to application of its per-mile cost factor, undertook to ascertain the mileage which the new buses would travel in place of the old. Transit was unable to respond initially to the Commission's request for information as to how the new buses would be alloted to scheduled operations because those determinations had not at the time been made. The staff then proceeded to allocate mileages to the new vehicles according to its own views as to the various routes on which Transit could best use them. The record discloses, however, that in the process the staff overlooked requirements which precluded many of the assignments it made.[273] And Transit made a convincing demonstration that, with valid assign-

---

on a unit basis by groups, and its projected expense did not reflect increased labor costs for 1966, which the staff computed separately. Without the additional labor costs, the staff's computation was 13.10 cents as of June 30, 1965, and its estimate for 1966 was 11.16 cents. Giving effect to the increased labor costs, the staff's projection for 1966 would be 11.61 cents. This would amount to a reduction in 1966 maintenance costs per mile of 1.94 cents, an amount almost three times the cumulative reduction over the previous three and one-half years, and almost five times the largest reduction in a single year since 1962.

There is no evidence in the record indicating that Transit's historical pattern of maintenance costs was inaccurate, or that it would undergo any dramatic change in 1966.

[273]Maryland's licensing and tax fees for new 51-seat buses are about $1,200 for the first year and about $200 for each year thereafter. These compare with about $75 per year in Virginia and about $35 per year in the District. Because of these differences, Transit used in Maryland only those buses—more than one-third of its fleet—already licensed to operate therein. The staff did not take into account the additional costs of licensing buses in Maryland which its reassignments—apparently in considerable number—would require.

In reassigning buses to regular route operations, the passenger capacities of the buses were almost entirely ignored. Thus, in some number of instances, undetermined on the record, it appears, 31-seat buses were reassigned to routes previously served by 51-seat buses.

ments, an application of even the staff's disputed cost-per-mile estimates would have resulted in 1966 maintenance expenses considerably greater than those predicted by the staff.[274]

The Commission itself concluded that "[t]he staff estimate appears low, due, at least, to bus-assignment difficulty"[275] but, because of alleged deficiencies in Transit's *computation*,[276] "accept[ed] as reasonable the estimated maintenance costs projected by the staff."[277] It was not, however, enough to validate the staff's "low" opinion, which the Commission incongruously embraced "as reasonable," simply to refer to claimed shortcomings in Transit's evaluation, which the Commission rejected Rather, it was incumbent upon the Commission, if dissatisfied with both,

---

[274]This projection resulted in a figure for 1966 bus maintenance costs that was $150,393 higher than the staff's estimate. Thus, the latter estimate of $574,578 less $148,040 for additional labor or a net of $426,538 in savings would be reduced by $150,393 to $276,145 in savings.

Transit made another projection, likewise applying the staff's unit maintenance cost factors to buses properly assigned, but considering also the aging of the buses and the decreased miles of operation of older buses. This, for 1966, resulted in a cost per mile of 1.92 cents higher than the staff estimate, and a total annual maintenance cost $674,478 above that computed by the staff.

[275]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 55.

[276]"Transit's original and rebuttal data fails [*sic*] to recognize any savings on account of the new buses in the latter half of 1965 and 1966—in fact, Transit persisted in adding $41,000 to costs of maintaining air-conditioning units. Transit also failed to consider savings which may result from projected consolidation of operating divisions in early 1966.

"The commission is not unaware of the fact in the last rate case involving D.C. Transit, Transit, by dint of careful management economies, was able to reduce operating costs in 1963 substantially below those projected in Order No. 245." *In re D.C. Transit, Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 55.

[277]*Ibid.*

to require whatever more it deemed essential to the performance of its duty to forecast Transit's bus maintenance expense with all the precision reasonably obtainable.[278]

We must sustain the Commission's findings when they materialize as rational deductions grounded on substantial evidence in the record considered as a whole.[279] But here the miscalculations to which we have adverted robbed the staff's estimate of the degree of reliability that separates admissible opinion from ineligible conjecture. We hold that the Commission erred in accepting that estimate as the basis for its finding as to Transit's expenses of bus maintenance during the future annual period.

VII
1965 Margin of Return

In Order No. 564, the Commission found "that a margin of return above operating expenses in the amount of about $2 million is fair and reasonable for 1966,"[280] the future annual period. Estimating that under existing fares Transit's net earnings would be only $648,357, but that the court-ordered reserve could provide the difference, it denied a fare increase and ordered that approximately $1,350,000 be paid to Transit from the reserve.[281] Petitioners in No. 20,201 challenge the adequacy of the Commission's findings as to margin of return and the related transfer of funds. We hold that the Commission's findings do not justify the return the Commission allowed or support the withdrawal from the court-ordered reserve.

---

[278] We do not mean to suggest that the Commission was obligated by the record to accept Transit's estimate.

[279] Compact, *supra* note 9, tit. II, art. XII, § 17(a); *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474 (1951).

[280] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 68.

[281] *Id.* at 69.

From the Commission's discussion we glean the formula by which it set the margin of return at $2,000,000. Additionally to Transit's estimated debt expense of $960,000, it allowed "$400,000 to $500,000" as an annual dividend[282] and "$550,000 to $650,000" as a "cushion."[283] The Commission's projection of Transit's debt service has not been challenged, and it has substantial support in the record,[284] so we have no difficulty with the treatment of that item. But we cannot accept the Commission's methodology as to the two remaining components of the margin of return it awarded.

Dividend Payout

As we said in *Transit I*, a "just and reasonable" rate is one that enables the utility, among other things, to "pay dividends sufficient to continue to attract investors."[285] But there we criticized the Commission's apparent treatment of an annual dividend payout of $500,000 as a "cost of operation, . . . with no examination of, or conclusion about, its appropriateness."[286] And elsewhere in this opinion we have noted that the mere fact that annual dividends in a particular amount have been paid in times gone by is in no sense a proper basis for permitting dividend payouts to continue at the same level in future years.[287]

As its sole reason for including in the margin of return

---

[282] *Id.* at 67.

[283] *Id.* at 68.

[284] The Commission's finding was that Transit's debt expense would be "approximately $960,000," *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 53 P.U.R.3d at 66. Protestants' expert witness adopted $957,000, the figure set by the Commission's staff accountant.

[285] 121 U.S.App.D.C. at 400, 350 F.2d at 778. But see note 34, *supra*.

[286] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[287] See notes 30-33, *supra*, and accompanying text.

"$400,000 to $500,000" for dividends, the Commission stated that "Transit has paid an annual dividend of $500,000 since 1960 and the testimony tends to show that the market place assumed the continuation of such dividend."[288] To the extent that the Commission's judgment as to a suitable dividend rests upon Transit's traditional dividend payout policy, it continues the approach we disapproved in *Transit I*[289] and which earlier in this opinion we held to be arbitrary.[290] However, the Commission's addition—that "the market place now assumes the continuation of such dividend"—poses the question whether that statement is tantamount to a sustainable finding that dividends lower than those paid historically would not be sufficient "to continue to attract investors."

The assertion that the market place "assumes" continuity in the amount of Transit's dividends could mean that absent the customary yield prudent investors would cease viewing Transit's stock[291] as a desirable investment, in comparison with other opportunities of similar risk, and thus that Transit would no longer be able to secure the equity capital it needs to assure its continued vitality.[292] If that were the

---

[288] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 66.

[289] 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[290] Notes 31-33, *supra*, and accompanying text.

[291] Transit is the wholly-owned subsidiary of a Delaware corporation, also called D. C. Transit System, Inc. See note 26, *supra*. For this reason it is presumably the market position of the parent's stock which would be affected by any change in Transit's dividend policy. See note 53, *supra*. It may be for this reason that the Commission found an appropriate dividend would be "$400,000 to $500,000"—$500,000 being the annual payout by Transit, and $400,000 being the amount historically passed on to the stockholders of the parent corporation, see note 31, *supra*,—without further particularizing its finding.

[292] Apparently, the company's management has seen little need to secure new equity capital in recent years, and has relied almost exclu-

case, the Commission would have ample justification for concluding that a return less than that required to maintain dividends at former levels would be unreasonably low. On the other hand, the observation that the market place "assumes" the continuation of a $500,000 dividend pay-out, could be understood as signifying only that a lower dividend yield might affect, to some degree, the market price of Transit's stock. And to say that the market price of the stock might drop to a price somewhat lower than it was in prior years is not at all to say that the company's ability to attract the equity capital it needs would be jeopardized.[293]

A method for determining a fair return or a reasonable dividend yield which looks solely to a pegging of the market price of the company's stock at past levels is manifestly unacceptable.[294] Past returns may have been unreasonably

---

sively on debt financing. See note 60, *supra*. The Commission did not comment on the testimony of Transit's Vice President that it has been able to secure financing for purchases of new buses without down payments, nor on the significance of its status as a wholly-owned subsidiary of another corporation, see note 291, *supra*.

[293]Strictly speaking, the integrity of existing capital is impaired only when the company is forced, because of unfavorable earnings, to issue new stock at less than the per-share book value of the old stock. Bonbright, *supra* note 34, at 249. Whether or not a company should be afforded an opportunity to earn a return high enough to bring some premium over book value for the company's stock, see note 34, *supra*, even a liberal return should be calculated to do no more than maintain a "reasonable relationship" between market price and book equity. Bonbright, *supra* note 34, at 249. In this connection, we note that there is evidence in the record that the 1961 market price of the common stock of Transit's parent, D. C. Transit (of Delaware) was more than 8 times greater than the book equity per share. This 8 to 1 ratio was far greater than that for any of twelve other urban transit companies studied. In fact, only two other companies showed a ratio as high as 2 to 1.

[294]*In re Public Serv. Co. of North Carolina, Inc.*, 33 P.U.R.3d 398, 412-13 (N.C. Utils. Comm'n 1960); *Wash. Public Serv. Comm'n* v. *Pacific Tel. & Tel. Co.*, 100 P.U.R. (N.S.) 309, 320 (Wash. Public Utils. Comm'n 1953); *In re Consumers Power Co.*, 82 P.U.R. (N.S.)

high, resulting in an inflated market price for the stock; if so, the public interest would not permit, much less require, maintenance of the status quo.[295] And even if past returns were warranted in the light of then existing risks and uncertainties, changed conditions may demand a lower return for the future, even if that results in the market's revaluation of Transit's stock.[296] In short, the Commission's duty is to authorize a return which is sufficient, but not greater than necessary,[297] to preserve the financial integrity of the enterprise, and which is fair and reasonable in the light of current conditions, as distinct from those that may have

---

97, 110 (Mich. Public Serv. Comm'n 1950); *cf. Cambridge Elec. Light Co.* v. *Department of Public Utils.*, 33 Mass. 536, 131 N.E.2d 922 (1956); see *In re Tennessee Gas Transmission Co.*, 24 F.P.C. 204, 207-08 (1960). Compare the Commission's "stock price stability theory," discussed in notes 30-33, *supra*, and accompanying text.

[295]See *Potomac Elec. Power Co.* v. *Public Utils. Comm'n*, 81 U.S. App.D.C. 225, 158 F.2d 521 (1946) (opinion of Edgerton, J.), *cert. denied* 331 U.S. 816 (1947); *In re Inter-Mountain Tel. Co.*, *supra* note 224, 59 P.U.R.3d at 344-45.

[296]In Order No. 684, issued March 13, 1967, the Commission found that, with the return therein allowed, the company would have available "something less than $430,000 in cash after meeting all other obligations;" and it added that it did not "anticipate that the entire amount of available cash would be used for dividends," since the company "is manifestly in a cash-short position." Order No. 684, *supra* note 34. The Commission explained why, despite the fact that "dividends will probably be at a level significantly lower than in some past years" it felt the return was adequate: "We do not regard this as requiring a larger return. The substantial risks the company faced in coming into the community at a difficult time and converting to an all-bus operation with a high standard of service may well have dictated a high return of capital in past years. As we look at the company now, however, it faces a more secure future than most transit companies, having a modest but definite growth potential. Dividends on the level which seem possible under our return allowance should adequately compensate the equity holder." *Ibid.*

[297]Compact, *supra* note 9, tit. II, art. XII, § 6(a)(3); see note 293, *supra*.

existed in times past.[298]

In support of its statement that the market place "assumes" continuation of past dividends, the Commission apparently relied on the testimony of Transit's expert witness that

> "if the annual payout [of $500,000] was not continued, the adverse effect on the market value of the stock of the parent would be considerable, and the financial stability of Transit would deteriorate in the eyes of the financial community."[299]

But this assertion, standing alone, does not provide adequate support for a finding that Transit's traditional annual dividend payout must persist in order to "continue to attract investors"—even assuming that such a finding was made.[300]

---

[298] *Transit I, supra* note 1, 121 U.S.App.D.C. at 402, 350 F.2d at 780.

[299] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 61. In addition to its reliance on this witness's opinion that the market place "assumes" continuation of a $500,000 payment, the Commission said that "[T]he expert witness for the protestant-intervenor did not agree with Transit as to the requirement for overall earnings, but he saw an advantage to continuing annual dividend payments at the $400,000 level, being the amount flowing through to the holders of the Delaware company's stock." *Id.* at 66. We find no indication in the testimony of protestants' expert that he "saw an advantage" in a $400,000 dividend. Indeed, though recognizing that payment of dividends "rests within the sound discretion of management," he suggested that Transit should consider reduction or elimination of dividends in the future annual period, since, despite excess earnings, the undesirably high proportion of debt in the company's capital structure had grown even larger in recent years. He added that if management nevertheless did declare a dividend, "obviously no greater amount is required than $400,000"—since that was the amount historically paid to stockholders of the parent, and "the relevant data for consideration here is the market performance of the parent's stock." See notes 291, 292, *supra*.

[300] That this is not what the Commission meant by its statement that the market place "assumes" continuation of a $500,000 payout is suggested, perhaps by its recommendation, later in Order No. 564, that the company forego payment of a cash dividend and substitute a

For, as we have said, whether or not a lower dividend would reflect adversely on Transit in the eyes of the financial community and thus affect the market price of its stock, it does not follow inexorably that Transit would thereby be precluded from securing needed equity capital. Whether the latter consequence would flow from a lower dividend yield is something the Commission could not know without at least ascertaining Transit's financial requirements, assessing the current risks that attend its operation, and examining "earnings on investments carrying comparable risks."[301]

As in the 1963 proceeding, both Transit and the protestants presented evidence relating to Transit's earnings-price ratios, and those of other companies; Transit's return on equity, and the returns afforded by natural gas and electric utilities, as well as other urban transit companies; and dividend-price and dividend payout ratios for Transit and other utilities. The Commission's opinion virtually ignores this information.

The Commission did observe that the protestants' "cost-of-capital method of determining a fair rate of return for Transit in this proceeding is not wholly applicable to the transit industry generally and to Transit in particular."[302] What the Commission meant by this is not clear. We can only infer that it had in mind considerations similar to those which led it to reject as "inappropriate" the cost of capital evidence adduced by the protestants in the 1963 proceeding, and we need not repeat our discussion of those reasons here.[303] It suffices to again point out that if a "cost

---

stock dividend. *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 71.

[301] *Transit I, supra* note 1, 121 U.S.App.D.C. at 401, 350 F.2d at 779.

[302] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 66.

[303] See the text *supra* at notes 48-53.

of capital approach" is to be dismissed as "inappropriate" or spurned as "not wholly applicable," it is incumbent upon the Commission to say why and to set forth for the record, through analysis and findings, the alternative method it employed to determine fair return.

The Commission made no evaluation of Transit's annual dividend payout or its overall return in the light of dividends and returns of companies of comparable risk.[304] Indeed, the only concrete finding based upon any of the evidence to which we have referred was that the $2,000,000 margin of return it authorized would produce a return on rate base of 7.4% which, it said, was "low."[305] In view of the Commission's failure to take into account the evidence we have summarized, and to weigh the considerations essential to a proper determination of a fair return, we cannot credit its

---

[304] Though the Commission did make findings as to Transit's book equity, *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 65, and the cost of servicing its debt during the future annual period, see note 284 *supra*, it never determined the return on equity that would result from the margin of return it authorized. Compare notes 68, 69, *supra*. Utilizing the Commission's figures for debt expense and book equity, the return afforded to the equity holder by an overall return of $2,000,000 would be nearly 23%. Transit's own exhibit of comparative data showed composite returns on common stock equity for 18 urban transit companies for 1960-1964 ranging from 1.16% to 7.73%. See notes 65-71, *supra*, and accompanying text.

[305] "Considering the numerous risks attendant upon Transit's operations, when such a return is related to other regulated utilities without similar risks, we feel that 7.4 per cent on Transit's rate base is low." *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 68. A little more than a year later, however, in Order No. 684, the Commission allowed a return on operating revenues of 5.24%, representing a return on rate base of 6.97%. Conceding that "both the dollar amount of return and the rate of return on gross operating revenues are substantially less than that allowed only a year ago in our Order No. 564," the Commission found that Transit "faces less risk than most transit companies." Order No. 684, *supra* note 34.

finding as to a reasonable dividend yield, resting as it does solely upon past payouts and unsupported inferences as to the market behavior of Transit stock.

The "cushion"

We also hold that the Commission has failed to justify its inclusion of "$550,000 to $650,000" as a "cushion" in the margin of return it allowed. The "cushion", the Commission stated, was the amount "required to enable Transit to maintain a sufficient surplus to cover contingencies and to assure the financial stability of Transit."[306] The Commission explained the need for the "cushion" as follows:

> "Admittedly, the commission has been conservative in its estimates for future revenues and expenses. In fact, the difference between the net operating income projections of the commission and Transit amounts to more than $800,000. The commission feels that in prescribing rates under the operating ratio method it should be careful not to overestimate revenues or expenses since the rate of return is directly geared to these items. If we, even inadvertently, should include margins of error, in the estimated operating revenues or expenses, we would be allowing a return on such errors. The great possibility of error in estimates and projections, a very real contingency, thus is better given weight here in the margin of return allowed than above the line where the effect would be compounded."[307]

The process of fixing rates prospectively necessarily imposes on a ratemaking authority the difficult task of estimating the utility's cost, in future years, of providing service to the public. Even the most intelligent estimate of future expenses, because it is an estimate, does not dispel completely the possibility of some inaccuracy.[308] Notwithstanding the

---

[306] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 67.

[307] *Ibid.*

[308] "An intelligent estimate of probable future values, . . . and even indeed of present ones, is at best an approximation. The like is true of a forecast of the extent of future revenues. There is left in every

uncertainty that attends all prophesy, a regulatory agency is duty bound to make its forecasts as accurate as it possibly can, and a reviewing court is entitled to assume that it has done so.[309] Nevertheless, without reference to any criteria whatsoever, the Commission here concluded that a "cushion" of from $550,000 to $650,000 was needed to offset the supposed unreliability of its estimates.

The Commission stated that "in prescribing rates under the operating ratio method it should be careful not to overestimate revenues or expenses since the rate of return is directly geared to these items. If we, even inadvertently, should include margins of error, in the estimated operating revenues or expenses, we would be allowing a return on such errors."[310] But there is no indication in this case that any undue possibility of error existed. Indeed, the Commission's estimate of revenue differed from Transit's by only $173,000[311] on projected revenues of some $33,000,000. Moreover, Transit's calculations did not take into account

---

case a reasonable margin of fluctuation and uncertainty." *Dayton Power & Light Co.* v. *Public Utils. Comm'n, supra* note 161, 292 U.S. at 310.

[309]The soundest estimate is one that contains an equal likelihood that the projection will be too large as that it will be too small. If there is no likelihood that a given estimate may be too large but a substantial one that it may be too small, the estimate is unreliable.

[310]*In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 67.

[311]Transit's original estimate of total operating revenues for 1966 under existing fares was $32,698,774. *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 52. The Commission's staff projected $253,797 more in regular route revenues and $410,000 more in charter revenues than had Transit. *Id.* at 53. Transit acquiesced in the adjustment for charter revenues, disputing only the increase claimed for regular route operations. *Ibid.* The Commission revised downward the staff's estimate of the latter, reducing the difference between the Commission's estimate of total operating revenues and Transit's to only $173,000. *Ibid.*

significant revenue increases in the second half of 1965,[312] and the Commission projected a smaller increase in passenger volume than Transit had assumed.[313] Thus it would seem that the revenue estimates, if at all unreliable, tended to favor Transit.[314]

The Commission's concern over the possibilities of additional costs is equally undocumented. All of the contingencies it identified as potentially enlarging expenses appear

---

[312] At the commencement of the 1965 rate hearing, neither the Commission's staff nor Transit had the full results of Transit's 1965 revenue experience from which to project 1966 revenues. Transit therefore based its revenue estimate for 1966 on revenues earned for the year ending June 30, 1965. However, before the Commission issued Order No. 564, it had before it the complete revenue experience for 1965. Transit's regular route revenue for the year ending June 30, 1965 was $29,837,656, and for the calendar year 1965 was $30,183,559. *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 52-53.

[313] In estimating regular route revenue for 1966, Transit assumed an "average increment of ridership of 2.3% in [the] ensuing year." It applied this figure to revenue and passenger experience for the year ending June 30, 1965, in order to determine anticipated revenue for 1966. See note 312, *supra*. Though the Commission's estimate was based on figures for the year ending December 31, 1965, thus taking into account the increased revenues in the latter half of 1965, see note 312, *supra*, it projected an increase in regular route revenue for 1966, over 1965 levels, of only 1.8%. Thus, had Transit's assumed growth figure of 2.3% been applied to actual revenue experience for the full calendar year 1965, the resulting estimate of regular route revenue for 1966 would have been significantly higher than that estimated by the Commission.

[314] One of the contingencies cited by the Commission in justification of the "cushion" was that "a mere 1% drop in passenger revenues under that projected by the Commission could result in a reduction of approximately $300,000 in collections in 1966." *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 67. But it is also true that a mere 1% growth in revenue would represent an increase of $300,000 and, if anything, the record tends to suggest this latter possibility as the more likely.

to be remote or speculative, and merely variations on the theme that its estimates might be erroneous. For example, even though it made no provision for additional track removal expenditures, the Commission stated that "the possibility exists that Transit might incur considerable expenses over and above the amount which remains in the track removal reserve in 1966. There is also the risk that the track removal program could be accelerated during the future period."[315] Similarly, the Commission said that there "is a possibility that the company will incur additional labor costs for the last two months of the year,"[316] without, however, undertaking to gauge the likelihood that its estimates of future labor expenses might be too low, or to quantify the additional cost of an erroneous projection.

Resort to a "cushion" cannot relieve the Commission of its duty to explore, and make findings on the probabilities of future occurrence of particular expenses. And the line between those costs that can and those that cannot be projected for ratemaking purposes must at all times be scrupulously observed. Expenses too remote or speculative to be forecast with any reasonable degree of certainty, and those that are extraordinary and not likely to recur in normal

---

[315] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 67. The record indicates, contrary to this assertion, that estimates of track removal expenses were likely to prove overgenerous. In 1965, track removal expenses were $702,000 less than had been projected. In explaining the delay in completion of planned track removal projects, an official of the Highway Department explained: "The problem in this construction, as in all constructions, you make your schedule and you try very hard to maintain your schedule, but you always have to figure there is going to be some slippage." The Commission, in dealing with the adequacy of the Reserve for Track Removal for 1966, noted the "considerable slippage possibilities in timing the projects." *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 51.

[316] *Ibid.*

periods,[317] should be disallowed. The Commission cannot "cushion . . . [the] company in advance against unforeseen events" which do not constitute "ordinary and necessary" expenses.[318]

The Commission, of course, was at liberty to allow a return which would enable not only the payment of an appropriate dividend, but also an addition to surplus of amounts necessary to insure financial stability and to provide to the equity holder a return which in the aggregate is fair and reasonable.[319] The error here is that, instead of making allowance for identified capital needs, and for an overall return "commensurate with returns on investments in other enterprises having corresponding risks,"[320] the Commission viewed the "cushion" simply as a means of offsetting possible errors in its expense predictions.[321] A fair rate of return, properly determined, already includes compensation for the risk that uncrystallized contingencies may later reduce

---

[317] *Michigan Wisconsin Pipeline Co.* v. *FPC*, *supra* note 118, 263 F.2d at 555.

[318] *American Overseas Airlines* v. *CAB*, 103 U.S.App.D.C. 41, 47, 254 F.2d 744, 750 (1958).

[319] See *Transit I*, *supra* note 1, 121 U.S.App.D.C. at 400, 350 F.2d at 778. See also note 34, *supra*.

[320] *FPC* v. *Hope Natural Gas Co.*, *supra* note 38, 320 U.S. at 603.

[321] The result of granting Transit a cushion of $550,000 to $650,000 over and above estimated operating expenses was to give it a return of 7.4% on its rate base and 6.03% of its operating revenue. The operating ratio of 6.03% was even higher than the 5.88% requested by Transit, and substantially higher than Transit's average operating ratio of 4.24% for the years 1959-64. In only one of these years did Transit's operating ratio exceed this amount. The return of 7.4% on rate base is substantially higher than Transit's average return from 1956-65 of 4.93% and higher than in all but one of those ten years. See also note 311, *supra*.

actual earnings.[322] But without comparative data, any determination of added risk in isolation is completely arbitrary.[323]

Disposition

In view of the fundamental inadequacy of the method by which the Commission determined the margin of return allowed Transit, we hold that its action in ordering $1,350,000 to be transferred from the court-ordered reserve was unlawful and must be set aside. Since Order No. 564, like Orders Nos. 245 and 563, has been superseded as a result of the Commission's subsequent approval of new fare schedules,[324] we will not remand the case for a new determination as to the margin of return.[325] However, as was our experience in connection with Orders Nos. 245 and 563,[326] we encounter substantial indications in the record that it would be inequitable to compel Transit to restore the entire amount it obtained from the reserve.[327]

---

[322]See *FPC* v. *Natural Gas Pipeline Co., supra* note 38, 315 U.S. at 597-98; *Driscoll* v. *Edison Light & Power Co.*, 307 U.S. 104, 120 (1939); *Pennsylvania Water & Power Co.* v. *FPC*, 89 U.S.App.D.C. 235, 247-48, 193 F.2d 230, 242 (1951), *aff'd* 343 U.S. 414 (1952); *Washington Gas Light Co.* v. *Baker, supra* note 94, 88 U.S.App.D.C. at 123-24, 188 F.2d at 19-20; *City of Pittsburgh* v. *Pennsylvania Public Utils. Comm'n*, 178 Pa.Super. 46, 112 A.2d 826, 837 (1955).

[323]The Commission advanced no basis whatsoever for its choice of the figure "$550,000 to $650,000," other than the fact that that amount approximated the sum remaining in the court ordered reserve, see *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 68-69.

[324]Note 90, *supra.*

[325]Notes 87 to 96, *supra,* and accompanying text.

[326]Notes 110 to 114, *supra,* and accompanying text.

[327]In any event, we do not think the amount of restitution required by our disposition of Order No. 564 could be greater than the amount transferred from the court ordered reserve. It is true that the fares collected by Transit during the effectivness of Order No. 564 were those prescribed initially by Order No. 245, and that we have set that

In Order No. 564, the Commission found that the fares prescribed therein would produce net income of only $648,357 in the absence of any transfer of funds from the court-ordered reserve.[328] This amount was substantially less than the $1,550,000 proposed by the protestants[329] as a fair return.[330] Moreover, though the protestants recommended a return on equity of from 12% to 13%,[331] and though we have affirmed the Commission's 1967 decision permitting a return on equity of 14%,[332] the $648,000 would have been insufficient even to cover Transit's estimated debt expense of $960,000[333] for the future annual period.

Since it was uncontested that Transit was entitled to a

---

order aside. Nevertheless, having suspended Transit's proposed tariff and having entered upon a hearing on the justness and reasonableness of the higher fares requested, the Commission in denying the fare increase prescribed a new schedule of "lawful fares . . . to be in effect," though the fares so prescribed were those previously in effect. Compact, *supra* note 9, tit. II, art. XII, § 6(a)(2). That aspect of Order No. 564 was not challenged by petitioners—*i.e.*, they did not claim error in the Commission's failure to reduce fares. See Compact, *supra* note 9, tit. II, art. XII, § 16. And the relief requested in this court is "restitution of amounts withdrawn from" the court ordered reserve. See also note 121, *supra;* notes 329-333, *infra,* and accompanying text.

[328] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 58.

[329] In speaking of the "protestants" herein we refer not only to petitioners Bebchick and Gottlieb, and the other individuals who were parties before the Commission but have not joined in this appeal, but also to petitioner Democratic Central Committee which appeared before the Commission as intervenor.

[330] *In re D.C. Transit Sys., Inc.* (Order No. 564), *supra* note 12, 63 P.U.R.3d at 62.

[331] *Ibid.*

[332] Notes 114, 115, *supra,* and accompanying text.

[333] Note 284, *supra,* and accompanying text.

return of at least $1,550,000,[334] and since that sum represents a return to the equity holder nearly identical to that approved by the Commission only one year later, we conclude that Transit should not be directed to make full restitution, if to do so would reduce its return below that level. Accordingly, Transit will be permitted to retain any portion of the funds transferred to it from the court-ordered reserve which is necessary to preserve its actual earnings during the period covered by Order No. 564 at the level conceded by the protestants to represent a fair return.[335]

VIII
SUMMARY

We here recapitulate, for the convenience of the parties and the Commission, the major dispositions required by the holdings delineated in this opinion.

Orders Nos. 245 and 563

Orders Nos. 245 and 563 are set aside. Transit is directe to make restitution for all amounts collected as a consequence of the fare increase initially authorized by Order No. 245, during the period that order was effective, except that it may retain any portion of the excess fares necessary to preserve its earnings at the level conceded by the protestants to represent a fair return.[336] Restitution in the appropriate amount is to be effected by placing funds in or making non-

---

[334] Petitioners, in their petition for reconsideration of Order No. 564, contended that "the Commission erred in failing to conclude that a fair return for Transit in 1966 would fall within the range of $1,500,000 and $1,550,000."

[335] See the text *supra* at notes 18-21.

[336] Protestants' expert recommended a return of $1,107,000, see note 47, *supra*. Evidence in the record suggests that Transit's net operating income was $2,133,331 for 1963, $1,127,859 for 1964, and $975,806 for 1965.

cash credits to the court-ordered reserve.[337] The parties are requested to seek agreement as to the precise amount of restitution and the details for its accomplishment. Should the parties formulate a plan, they shall make application to the Commission for its approval, and in that event, or if no agreement is reached, the Commission shall supervise the execution of our mandate.[338]

Order No. 564

The issue concerning the acquisition adjustment account is remanded to the Commission for a redetermination of the schedule for amortization of the balance thereof on the changeover date, and a relating of that schedule to the remaining lives of the properties in service on the changeover date. Any amounts heretofore charged against the account in excess of the amounts found to be proper shall be deposited in the court-ordered reserve.

The issue concerning the deficiency in the depreciation reserve is likewise remanded to the Commission for findings as to the extent, if any, to which Transit's investors have already been reimbursed for the diminution in value of their investment in operating properties devoted to public use over and above accruals to the reserve. The Commission may permit Transit to retain any portion of the total amount of underaccruals for which its investors have not been compensated in the form of past earnings in excess of fair returns. Any amounts permitted by Order No. 564 to be withdrawn from the court-ordered reserve for which Transit's investors have already been so compensated shall be restored to the reserve.

---

[337] All funds to be deposited in the court-ordered reserve are to be employed by the Commission in the manner and for the purposes described in *Bebchick* v. *Public Utils. Comm'n, supra* note 15, 115 U.S.App.D.C. at 232-33, 318 F.2d at 203-04. See the text *supra* at note 194.

[338] See *Washington Gas Light Co.* v. *Baker, supra* note 88, 90 U.S. App.D.C. at 104-05, 195 F.2d at 35; *S.W. Bell Tel. Co.* v. *Kansas City Corp. Comm'n, supra* note 120, 53 P.U.R.3d at 338.

The Commission on remand is further directed to make findings and conclusions as to the treatment proper for Transit's investment tax credits, and the amounts, if any, by which Transit's federal income tax expense should be reduced as a consequence of any such credits. To the extent the Commission may find that Transit was permitted to accrue excessive income tax expenses for 1966, the amount thereof should be placed in the court-ordered reserve.

The Commission's authorization of a margin of return of approximately $2,000,000 is set aside, as is its action, in consequence thereof, permitting $1,350,000 to be transferred to Transit from the court-ordered reserve. The funds so transferred shall be restored to the reserve, except that Transit may retain any portion thereof necessary to preserve its net income at the level recommended by the protestants as a fair return.[339] As in the case of Orders Nos. 245 and 563, the parties are requested to seek agreement and apply to the Commission for its approval, and the Commission shall supervise the execution of our mandate.

Although we have also held that the Commission erred in its estimate of Transit's bus maintenance expenses for 1966, we make no separate provision to offset, by any amounts improperly disallowed, the sum which Transit is compelled to restore to the court-ordered reserve. For our disposition of the matter of restitution allows Transit a return computed on the basis of its actual experience during the period in question, and thus necessarily compensates it for all out-of-pocket expenses legitimately incurred.

So ordered.

DANAHER, *Circuit Judge*, concurs in the result in Nos. 20,200; 20,201; and 20,202; and in the opinion in No. 20,202 insofar as affirmance is directed.

---

[339] As of August 31, 1966, Transit's net operating income for the year, including an annualized 8/12 portion of the credit from the court-ordered reserve, was $1,318,557. Projected over the remaining months, this would represent net income for 1966 of approximately $1,978,000.

WRIGHT, *Circuit Judge, concurring in part and dissenting in part:* I concur in Judge Robinson's excellent opinion except for the following reservations with respect to Part IV relating to the handling by the Commission of the investment tax credit.

I agree with the majority's statement that the Commission "was in error if it felt that it was inexorably bound" by Section 203(e) of the 1964 Internal Revenue Act to give the carrier, as distinguished from bus riders, the benefit of the investment tax credit since that section "applies only to an 'agency or instrumentality of the United States,' which the Commission clearly is not." However, the majority then states that "the issue does not vanish here, for the Commission's authority to administratively adopt the canon expressed in Section 203(e) is something else again." The majority quotes language from *City of Chicago* v. *F.P.C.*, __ U.S.App.D.C. __, __ 385 F.2d 629, 635 (1967), to the effect that "[a] regulatory agency may, should, and in some instances must, give consideration to objectives expressed by Congress in other legislation * * *," and the remainder of Part IV implies that the giving of such consideration is appropriate here and that the Commission is to be faulted only because it blindly adopted the policy of Section 203(e) instead of exercising in a meaningful way the "discretion" it possessed to do so or not.

My disagreement with this part of the opinion stems from my belief that, since Section 203(e) is not applicable, the Commission cannot give any consideration to the policy embodied therein. In other words, the Commission has no "discretion" to deny the farepayers the benefits of the investment tax credit savings. I rely specifically on the language quoted by the majority from *F.P.C.* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 244 (1967): "[W]here the out-of-pocket tax cost of the regulated [taxpayer] is reduced, there is an immediate confrontation with the ratemaking principle that limits cost of service to expenses actually incurred." As this statement recognizes, basic to all rate-

making is fixing rates in terms of actual costs and that, of course, includes the actual cost of federal income taxes as well. To hold that the Commission has the discretion to fix the rates on the basis of total federal income tax liability without subtracting the amount of the tax credit which Transit is entitled to, and in fact takes, flies in the face of this principle.

I do not think that anything in our *en banc* decision in *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 115 U.S.App. D.C. 8, 316 F.2d 659 (1963), precludes our holding in this case that the Commission does not have the discretion to set a rate which is not based on a total flow-through. Certainly the spirit of *Panhandle* is that tax benefits should flow through and, although we there affirmed the Commission's discretion not to give the consumers the total benefit of the revenues generated by Panhandle's use of Section 167's authorization of accelerated depreciation, I think that part of the decision turned on the fact that accelerated depreciation is merely a tax deferral and not a tax saving like investment tax credit. We stated in *Panhandle:*

> "* * * The liberalized method provides higher depreciation deductions and therefore lower taxes during the early part of the life of a given property, and lower deductions and higher taxes in the later years of the life of the property. The total depreciation deductions available to a company over the entire life of a facility are the same using either method. * * *"

115 U.S.App.D.C. at 10, 316 F.2d at 660. In this case giving Transit the benefit of Section 203(e) would result in a rate predicated in part on hypothetical costs not expended—on taxes never to be paid. This, in my judgment, would be contrary to the fundamental principle of ratemaking.

BEFORE THE

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

Washington, D.C.

ORDER NO. 563

IN THE MATTER OF:		Served January 26, 1966
Application of D. C. Transit System, Inc., for Authority to Increase Fares.	)))	Application No. 226 Docket No. 32

APPEARANCES:

As previously noted.

SUPPLEMENTAL FINDINGS TO ORDER NO. 245

On April 12, 1963, the Commission entered its Order No. 245. That order, inter alia, authorized D. C. Transit System, Inc., (Transit) a 1¼¢ increase in token fares, from 5 tokens for $1.00, to 4 tokens for 85¢. Transit, protestants Williams and Trask, and the intervenor General Services Administration sought review.

On April 8, 1965, the United States Court of Appeals for the District of Columbia Circuit handed down its Opinion, remanding the case to the Commission "for further proceedings consistent herewith to determine the margin of return over and above operating expenses that Transit should be allowed." *D. C. Transit System, Inc., v. Washington Metropolitan Area Transit Commission*, 350 F.2d 753 (1965), at 780. Additionally, two other matters were raised in the opinion which require our attention and consideration.

It should be noted that the composition of the Commission has changed since the issuance of Order No. 245. Two new members are now on the Commission and this factor alone requires a new and comprehensive analysis of the record by the entire Commission.

The Commission is of the opinion that further hearings are not necessary. Pleadings filed with the Court subsequent

to the date of the Court's opinion consumed several months. Before the Commission could act, Transit filed a new application for increase in fares. Voluminous data was developed at hearings on the new application. We feel that all answers to questions raised in the remand opinion not existing in the record of this proceeding are contained in the record of the new proceeding. A separate proceeding to redevelop facts already before us would be undesirable. Therefore, where it has been necessary for us to utilize the new record, we have so indicated.

The Commission now addresses itself to the question as to whether any portion of the proceeds from the sale of the Georgia and Eastern Terminal should be passed on for the benefit of the riders. The Court Opinion states, "The only evidence before the Commission regarding this sale does indicate that the terminal was sold more than three months after the close of the audit period on which the Commission's projections are based. This may explain why no effort was made by any party to establish the reasons for the sale." *D. C. Transit System, Inc., v. Washington Metropolitan Area Transit Commission*, 350 F.2d 753, at 775-776. A review of the transcript reveals that retirement of this property was not associated with the retirement of rail property. While the rail system was in use, the Georgia and Eastern Terminal served in a dual capacity, both as a terminal for rail service and for bus service. After the rail system was phased out, the terminal was used exclusively in bus operations. Sometime thereafter, due to request of riders to move the terminal further north, the company relocated its terminal in Silver Spring and discontinued the terminal facilities at the Georgia and Eastern location. It is apparent to the Commission that the termination of this facility as property used and useful in the transit business was predicated solely on a realinement of its bus terminal facilities and its removal from service was completely disassociated with the termination of the rail operation. Thus, it is our determination that the sale of the terminal was occasioned neither in whole nor in part by the abandonment of rail

operations. Therefore, the ratepayer is not entitled to share in any portion of the proceeds of that sale, unless there was a profit on the depreciable portion of the asset sold. There was none in this case.

The second question raised by the Court in its opinion related to depreciation. The issue was raised that the Commission should not have used the $693,870 depreciation allowance because there may have been an over-accrual in the depreciation projected as of August 15, 1963. The Court noted that the evidence was incomplete and contradictory and based largely on transactions that occurred after the close of the audit period. Now, however, all the results are in. August 15, 1963, has come and gone since the Commission entered its order. By Order No. 289, served July 29, 1963, the Commission ordered a full scale depreciation study of all operating property of D. C. Transit System, Inc., other than buses. The Stone and Webster Service Corporation, consulting engineers, was engaged to make the study and prepare a report. The Stone and Webster Service Corporation submitted its final report to the Commission on the date of July 1, 1964. By Order No. 381, served September 11, 1964, the Commission noted as follows: "At the 1963 hearing, the Washington Metropolitan Area Transit Commission staff pointed to the possibility of an over-accrual of $305,559 against rail properties as of August 15, 1963, due to a favorable salvage experience. The Commission took cognizance of this possibility and of the equal possibility that offsetting under-accruals in other accounts may develop by August 15, 1963, stating that it will consider ordering a new depreciation reserve study at an early date." This study resulted in a determination by the Commission that there was in fact an under-accrual of the depreciation reserve, or, stated another way, that the depreciation reserve was deficient by $1,223,099.04. Therefore, we find there was not an over-accrual of depreciation and it is not necessary to make any adjustment in the $693,870 allowance.

In Order No. 245, future results under fares prescribed by the Commission were estimated to be as follows: Operating Revenue – $30,420,638; total Operating Revenue Deductions amounted to $28,939,892, resulting in net operating income of $1,480,746.

The Court expressed no opinion regarding the adequacy or inadequacy of the return allowed by the Commission, for it thought that the order did not admit of the kind of meaningful judicial review contemplated by the statute. A "just and reasonable" rate, we are told, is one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability. As we have previously set forth the legitimate operating expenses, we now turn to an accounting of the 4.87% of the total revenues expected to be realized from the approved rate structure and to explain why this is the appropriate margin.

During the hearing the Company stated that it would purchase 75 new buses in the year 1963, under certain circumstances relating to changes in its depreciation rate. In its decision the Commission authorized a change in the depreciation schedule, decreasing the depreciation period from 17 years to 14 years for all buses placed in service subsequent to 1956. Additionally, the Commission required Transit to place an order for 82 new, air-conditioned buses to be placed in service on or before October 1, 1963, and beginning in 1964, ordered Transit to purchase on the average each year a number of new, air-conditioned buses equal to 1/14th of the buses in its fleet. The cost of a new bus at that time was estimated at $33,500. In the past, Transit was able to finance its buses generally over a ten-year period at a 6% interest cost. Additionally Transit opened and dedicated its new bus maintenance base on October 30, 1962. The cost of the building, including land, is approximately $3,500,000, of which $1,800,000 is being financed.

The Company presented testimony that its system rate base as of August 31, 1962, was $21,583,740. This includes an amount for working capital for materials and supplies as of that date in the amount of $607,290. It estimated its rate base as of December 31, 1963, in the amount of $24,512,390. This rate base includes working capital for materials and supplies in the amount of $635,664. The Company also presented testimony and exhibits relating to a quantitative study of the comparative cost of capital among public utility groups for a period of years between 1959 and 1961. Its Exhibit No. 33 was designed to show the capitalization of a large number of utility companies as classified in various categories, including Transit, within the period of 1959 to 1961. Its expert witness testified that the transit industry secures a relatively small part of its capitalization from debt sources, which he stated is the lowest cost of capital. He further noted that telephone companies have historically relied less on debt capital than on equity capital. In developing the cost of debt capital, applicant considered the bonds and notes of specified companies by groups, and attempted to determine the market value of debt capital by taking an average of the high and low price of the various bonds and notes, and multiplying that by the face value of the bonds outstanding. He divided the market value of the debt capital into the interest payments on bonds and notes, to develop a range of yields, for the four stable utilities. These ranged from 3.97% for electric light and power to 4.16% for water companies. The average without weighting for the four groups was 4.2% as the price of debt capital for a stable utility, whereas in the transit industry the price was 6.22%. He concluded that the transit industry, in a three-year study period, based upon market evaluation of its securities, paid approximately 1½ times as much for its debt capital as the so-called stable utility.

He made a similar analysis for equity capital, including both preferred and common stock. Again he used the same procedure. He developed an average yield on preferred and

common stock equity. He found that for the stable utilities there was a yield ranging from a minimum of 3.4% to 4.4%, whereas transit common stock was being sold, based upon dividend yield, to pay 6.8%.

This witness further noted that the prime market rate for money lay between 3 and 4 percent, and that the investor who puts his money in something that is not prime is looking for a return that relates in some manner to the risk. He then developed the premise that risk in the telephone industry, for example, is very much less than the risk in investing in the transit industry. Accordingly, the earnings of telephone securities were 4.9%, whereas the earnings on transit stock were shown to be 8.7%.

The applicant also presented cost studies as developed on a price-earnings ratio basis. The company then attempted to consolidate the capital of all types, bonds, notes, and preferred and common stock, and then developed the average return on the market evaluation of securities for the various industries. Transit's expert witness concluded from his study that the investor who was in possession of funds and who was interested in utility investment was demanding a much higher return on his money when he put it in the transit industry than if the same dollars were to be put in a stable utility. He declared that the reason for this was very obviously based upon the fact that transit earnings are highly volatile. He also concluded that everyone realized that an investment in the transit industry is hazardous and that the industry is not favorably looked upon by the investing public. Relating his expert testimony on the cost of capital to return on rate base, Transit's expert witness concluded that an investor would look for a return in a single transit company, of about 10% after taxes. This, then, was the appropriate base upon which to compute the reasonable earnings of such a transit company, based upon the value of its property rather than the value of its securities. The earnings should, in his opinion, be related to the physical value of the plant that is devoted to public service. The witness also prepared a study covering the same group of transit companies showing their earnings per

share of common stock over a period of several years. His exhibits and testimony were to the effect that earnings of D. C. Transit System, Inc., of Delaware, had been 12.92%, or very close to the median for the entire group of transit companies that he studied. He concluded from his testimony and exhibits that the market appraisal of D. C. Transit stock is such that the investor is asking for a little higher return on his security than for the average of the transit companies studied. He also presented the results of a study relating to the earnings as a percentage of the average market price of the common stocks of the companies he studied, including D. C. Transit System, Inc., of Delaware. He found that the dividends will generally run less than the earnings, and he further found that the dividends of the companies studied ranged from a high of 10.3% to a low of 4.8%. He stated that the mid-point of the sixteen companies he studied was approximately 7%, which was almost exactly what Transit had paid in relation to the average market evaluation of its Class A securities on the open market during the preceding three years. However, all of this witness' testimony was developed on reported book figures contained in Moody's and other manuals and sources of information. And his testimony must be qualif. d by his admission that he had no details on the finances of either D. C. Transit of D.C. or D. C. Transit of Delaware. What the witness attempted to convey was a typical picture of the industry based on a representative group of representative companies. The witness defended his hypothetical mix of capital results, declaring that he knew what the debt capital was going to cost and he knew, on the basis of industry experience, that a company is going to have to pay a great deal more for equity than for debt. He then qualified his hypothetical cost of capital by stating that even the result is not necessarily what would be a proper return, because you must allow, in any theory of return on rate base, the company to carry forward into surplus a certain amount of money to enable it to maintain itself against the "vicissitudes" of the future. While he said it would cost 7.8% to get the money, he went

on to say that this would not necessarily be a fair return. He noted, additionally, that the investor is looking for a return on what he actually paid. He also noted that the market price of various utilities is in a sense dependent upon the actual value of the assets of the utility. Although he admitted that companies often sell for eithr more or less than their asset value, they very seldom ever, he declared, sell exactly for the book value. As the witness stated, "I have developed theoretical figures to show what could be accepted by the Commission as a reasonable return." In recommending that a return of 6.8% on rate base was reasonable, the witness was predicating his testimony on a rate base of approximately $23,000,000.

This expert witness also recommended an operating ratio for Transit of 93% - 95%, which was based upon a study of rate decisions made by various utility commissions over the past twenty years. The witness noted that there was a prevailing tendency to establish a rate on an operating ratio in that range in those cases where the rate base is substantially less than annual revenues. The witness also explained his theory of the fundamentals of the operating ratio in the rate-making process. Generally, he stated, the operating ratio had been used for about twenty years by regulatory commissions in motor carrier cases as a measure of the amount of money that is required to maintain a healthy operating company. The reason he gave for the use of the operating ratio method in motor carrier cases as contrasted with the rate base method, is that the plant and equipment required by a motor carrier is generally less in dollars than its annual revenue. The risk, he stated, that is incurred by the investor in a transit company is a risk that it may not be able to meet its operating expenses. In elaborating upon this point he said:

> "In the case of the stable utility, as I referred to them before, the rate base is usually four or five times the annual revenue and relating the return to the rate base leaves a very substantial cushion in dollars to protect against contingencies and to insure

> the solvency of the company; whereas, if, in the case of a motor carrier with a low rate base in proportion to revenue, a return is allowed only on the rate base, there is a very substantial hazard that the company may not have enough money to meet its operating expense.
>
> "So that, in the last analysis, what is required, and what operating ratio does, is to assure enough money to attract capital and to provide sufficient income over and above operating expenses to insure the financial soundness of the company, giving due consideration to the fact that there are many elements inherent in the transit industry that differ from those of the other utilities."

After enumerating the economic factors which distinguish the transit industry from other utilities, and from unregulated industries, the witness declared that the risk factors inherent in the operation of the transit industry are so much greater than the risk factors involved in the operation of any other utility that the dollars that are left over after meeting operating expenses should be higher in proportion to the total than in a stable utility.

The staff accountant computed Transit's rate base for the base period to be $17,466,137, and estimated the applicant's rate base at the end of the future annual period, December 31, 1963, to be $24,682,314. He then adjusted this figure by removing the balance of the acquisition adjustment account, which finalized his estimate of the rate base to be $22,104,219.

The protestants would allow the company a margin over expenses to (a) pay estimated debt expenses, and (b) pay a fair return to the stockholders on their equity in the company. Fair return on equity was determined by an earnings-price ratio. This ratio, their expert stated, represents the evaluation of the market place. He went on to say that it represents what the people who have capital are willing to put into an enterprise. He stated that it was his belief that a return based upon the cost of equity capital is a fair

return to allow a public utility. Thus he would allow a margin sufficient to cover all cost of operations, all its interest expense, and a return to the investors. Therefore, he rationalized, after you have taken care of the debt obligations by covering all the interest, you have to look to see what you give to the investor. That, he stated, was the way to develop the fair return to the investor. This witness concluded that a fair return to equity stockholders be based on the cost of equity capital. The basis for this recommendation and that of the cost of equity capital is indicated by the earnings-price ratio that he developed. In support of this theory, he stated that this Commission should consider giving that return to the equity stockholder which maintains the price of his stock at the level of the book value of that stock. This is important, he stated, because the stockholder is entitled to earn what the market place says it is worth, and the earnings-price ratio is the measurement of that worth; the giving of a return to equity based on the earnings-price ratio by the Commission will allow the price of the stock to hover about the book value and this in turn means that the stockholder can always go to the market place, sell his stock, and get back for it what the stock is worth according to the books of the company. The witness developed his earnings-price ratio by referring to financial figures relating to twelve transit companies, over a ten-year period. Looking at that group as a whole, he determined an earnings-price ratio of eleven, which, he stated, was a somewhat lower ratio than for Transit. He recommended a return on equity for Transit in this case, arrived at from his study, of 12%. This upward adjustment was made because the twelve companies he studied have lower debt ratios than Transit, and that the cost of equity would increase as the debt ratio increased.

He then developed earnings-price ratios for twenty-four electric utilities and the American Telephone and Telegraph Company, and also referred to a study made by a public accounting firm. After averaging these ratios in each year, he plotted the results on a graph, and drew the conclusions

from the graph that large transit companies have higher cost of equity capital than the more stable utilities. This witness also set forth the earnings-price ratios of the publicly traded Class A stock of D. C. Transit System, Inc., of Delaware. This publicly traded stock of the Delaware parent, he stated, is a good index of the Transit Company's cost of capital, since the transit company represents the only substantial asset of the Delaware holding company. He then stated, "While the Class A stock of the parent has not been traded for a sufficient period of time to be used as an independent basis for determining Transit's cost of equity capital, it does provide a useful check point, to the extent that market data regarding the local company is available.

"It indicates that the cost of capital which I have recommended, based on the average experience of comparable transit companies, is conservative and perhaps on the high side of a reasonable range."

Translating this to dollars, it was the witness's opinion that Transit should be permitted to earn approximately $1,107,000 in the future annual period to cover the cost of its debt services and to provide a fair and reasonable return to the investors. This amount was further broken down by allocating $602,089 to interest payments and the balance, $504,838, as the fair return on equity, which he developed by multiplying his return factor of 12% on his developed average book equity figure of $4,206,990 for the year 1963. He thought this return was fully adequate and sufficient to provide both for the payment of reasonable dividends and for an increment to earned surplus. However, the witness made no attempt to break down this return and develop what would be an appropriate dividend, nor did he develop how much an increment to earned surplus should be provided.

On cross-examination the witness testified that he did not go into operating ratios on his direct testimony nor had he ever testified in the area of operating ratio theory. It was his view that the concept of the operating ratio as a

method of determining rates is a tool, but to be used only in conjunction with a rate of return on investment. He further stated that he would prefer that the operating ratio method should not be used in this proceeding, and for this reason he used strictly a cost of capital investment method of determining what would be a fair and reasonable rate of return. He went on to state that if the operating ratio method were used, then he would consider his cost of capital determination and conclusions as a test of the reasonableness of a particular operating ratio. The witness also admitted that he knew of no case in which a commission had adopted or used earnings-price ratio statistics in testing the rate of return computed under an operating ratio.

An agency of the United States government, the General Services Administration, presented a witness who testified as to the make-up of the rate base. He stated that he adopted the rate base figure before acquisition adjustment per the staff in the amount of $24,682,314. He proposed that the Commission should decrease the estimated rate base for 1963 in two ways: modify the rate base by deducting the balance in the acquisition adjustment account and the balance in the reserve for track removal and repaving. These two modifications total $5,753,715. This results in a modified rate base as of December 31, 1963, in the amount of $18,928,599. He then determined an average rate base by adding the above described modified rate base with a reconstructed rate base for August 31, 1962, arrived at after similar adjustments, in the amount of $12,610,312.

This witness did not offer any testimony as to rate of return.

The testimony in this proceeding further indicates that the market value of the D. C. Transit of Delaware stock for 1959 averaged $12.00 a share, $10.50 a share in 1960, and $11.70 a share in 1961.

We have before us then an abundance of testimony relating to returns authorized and/or earned by transit companies, telephone companies, electric companies, and gas companies.

This information allows us to examine earnings on investments carrying, to some degree, a comparable risk, and are of some value when considered in relation to this particular company. No single rate of return is universally applicable to all transit companies in the United States. A fair rate of return varies with the times and conditions of a particular company as these conditions and opportunities exist at the time of the weighing of the facts in the making of a determination. What constitutes a reasonable rate of return is a question of fact, the solution of which calls for the exercise of sound judgment and common sense by the Commission.

We have weighed very carefully all testimony and exhibits in this proceeding, along with supplemental data where noted. We are of the opinion that fares producing an operating ratio in the range of 95 to 95.5 constituted a fair and proper return. The projected net operating income of $1,480,000 was the amount necessary to enable Transit to service its debt, pay reasonable dividends, retain a reasonable portion in its business, and to attract investments of private investors. It was, in addition, the amount necessary to maintain investor confidence and to protect the company from the risks peculiar to the transit industry and to Transit itself.

While there was no direct testimony as to the dollar amount required to be available for dividends, the record does show that $500,000 has been paid out annually over past years to the investors. In view of the fact that in the past three years the market price of the parent company has been relatively stable, it appears to us that the margin of profit allowed by the Commission was fair and reasonable to both the investor and the consumer.

We have taken every effort to insure that the fare payers pay no more than is necessary to insure the continued adequacy of the company's service and provide a return to the shareholders that is reasonable under the circumstances. For example, it should be noted that of the various fare resistance factors advocated before us, we have adopted the most

optimistic. Thus, if we have over-estimated projected revenues by as little as one percent, the Company would receive $304,000 less net operating income. A net operating income of $1,176,746 would, in our opinion, be less than a fair return. On the other hand, we cannot close our eyes to the fact that the Company had estimated additional labor increases alone in the year 1964, in the amount of $900,000. Thus, a so-called bare-bones rate of return in 1963 could impair the financial stability of the Company, prompt an early return for a fare increase, and disrupt the measure of stability that has been achieved since 1956.

However, in order to determine the reasonableness of our decision, we look to a cross check of the rate of return on a net investment rate base. We find the staff's projected rate base for the future annual period of $22,104,219 to be the most accurate and reasonable presented in this proceeding. The operating income authorized Transit herein would produce a return on rate base of approximately 6½%. This would, in our opinion, indicate that the Commission has been conservative in the return authorized Transit. Moreover, we have considered but placed little emphasis on protestant's recommended rate of return utilizing the cost of capital method. It should be noted that more traditionally the computation of the cost of capital is done by determining the cost of debt and of equity and weighting the two for a composite rate. The protestants in this case disregarded this traditional method. We feel that the cost of capital method utilized is inappropriate in determining a proper rate of return for a transit company. Our view is reinforced when we consider the capital structure of this particular company. Other factors in addition to cost of capital should be considered in making the return allowance. These additional factors include the degree of risk involved, a comparison of earnings, the ability to attract capital, the economic conditions of both the market place and the community, the efficiency of management and the contribution to surplus. We have seen that the recommendation of the protestant's expert witness is based not on a mathe-

matical formula but a weighing of any judgmental factors. Thus, the "judgment" factors tend to undermine the objectivity of the end results. This is especially true when the answers given by the witness on his cross-examination are compared with his direct testimony.

Indeed, the unusual capital structure of this Company has required all expert witnesses to depart from the norm, and exercise to a great degree their own individual judgment in consideration of the transit industry generally. The capital structure of this Company is a paradox. In an industry having a predominant capital structure of much equity and little debt, Transit's is just the opposite. And this of course has mixed results. On the one hand, the top-heavy debt structure allows the company to secure cheaper capital and allows the ratepayer to benefit from the income tax benefits. On the other hand, it undoubtedly raises the cost of equity capital and could, in fact, result in a higher cost of debt, especially in the future.

The Commission has been directed to make "a careful review and analysis of the earnings experience of Transit from its inception, and of what that experience has meant to the equity owners, both by way of dividend payments and growth in book values through retained earnings." *D. C. Transit Sys. v. Wash. Metro. Area Trans. Comm'n*, 350 F.2d 753, at 780.

Investors have three goals: safety, income, and capital growth. The mix among these factors varies between investors.

Transit purchased the predecessor company for the sum of approximately $13.3 million. The book value of the property it purchased was approximately $23.8 million. The terms of the purchase included a $500,000 cash down payment, with the balance of the transaction covered by long-term notes. Testimony indicates that the equivalent price per share of stock at time of purchase was approximately $14.00.

We understand that the basis for the Court's suggestion to review past earnings is to help us arrive at a determination as to what might be a reasonable amount of earnings in the future. We are confident that the Court was not suggesting that we determine that the Company's future revenue should be offset by excessive earnings in the past, any more than we could require the future ratepayer to make up the difference of insufficient earnings in the past. We have, then, utilized our fndings as to past earnings only as an aid in arriving at a determination as to what are reasonable earnings for the future.

Turning now to an analytical review of past earnings, we look to see if the stock can be considered relatively safe as an investment; whether dividend growth has occurred and to what extent, over the years; and whether there has been a stable capital growth. The answers to these preliminary questions will aid us in determining the scope of our inquiry.

We take notice of staff Exhibit No. 14 in the case now pending before the Commission for decision (Docket No. 101). This document, and the accompanying testimony, reveals that Transit has, since its creation to June 30, 1965, received $10,327,035 in net earnings. Interest payments have totaled $4,310,577. Other non-operating income has added $411,776. Direct charges or credits equal $1,524,591. Dividends in the amount of $3,890,000 have been paid, leaving a balance, as of June 30, 1965, of $4,062,825.

This balance must be tempered, however, by the fact that Transit received an extraordinary $2,251,218 profit from the sale of the Fourth Street properties in 1959. Thus, in analyzing the history of retained earnings of Transit, we find that the net operating income minus interest and dividends equals $2,126,458. Thus, over an approximate nine-year period, Transit has averaged, after payment of interest and dividends, an annual accrual to retained earnings of $235,000.

The net operating income of Transit through 1962 was relatively stable, profits ranging from $818,000 to $1,404,-000. There has not been a year in which the Company operated at a loss. The rate of dividend growth has been zero since 1960. Considering the "inflationary" period since 1958, the income-providing ability of the stock has not increased at all.

Changes in market price alone do not provide a complete picture of capital growth. The subjective test of stock growth is an increasing trend in net earnings. Ignoring non-operating income and loss (which fluctuated wildly) and direct charges or credits (which also fluctuated greatly) to eliminate abnormalities, we note little growth trend in the earnings per share.

These factors standing lone have significance, but one must turn to an analysis of stock price for a determination of their effect. If the earnings were either excessive or too low, one thing would, in all probability, have occurred: increased trading and speculation would have caused the market price of the stock to vary drastically. The degree of stock price stability in the market place indicates to us that earnings in the past have not been excessive.

Transit has not been unknown to the regulatory agency having jurisdiction since its inception. The records show that its earnings have been scrutinized on an annual basis, for tax certification purposes. It has also been before the regulatory agency for rate cases in 1958, 1960, 1961, and in 1962-63. Probably no other regulated company in history has been subject to such an exhaustive earnings review. The District of Columbia Public Utilities Commission has enjoyed a reputation for expertise in the ratemaking field. In our review of its past decisions, necessary for other reasons in this proceeding, we have noted its exhaustive deliberations concerning this Company. We are convinced that the past earnings allowed Transit have enabled investors to maintain confidence in their investment, having received reasonable dividends and a slow, but steady growth, in book values

through retained earnings. On the other hand, the Public Utilities Commission never ignored its role as the protector of the consumer. Its deliberations, moreover, have been reviewed by the judiciary and, where required, adjustments have been made. For example, $500,000 was removed from retained earnings in 1963 by Court order. This, we feel, has cured any excessive earnings which the Company may have realized in the past.

How does the fare structure prescribed by the Commission compare with the transit industry throughout the country? A summary of fares in cities having a population of 250,000 or more—excluding municipally-owned companies—showed that of thirty-seven companies, two had cash fares of 30¢, eighteen companies (including Transit) had 25¢ cash fares, and seventeen had less than 25¢ (ranging from 10¢ to 23¢). Token prices, transfer charges and weekly and commutation passes, revealed a veritable potpourri of prices. However, any discussion of fares must also recognize the greater importance of the token fare structure, for it is this fare which most affects the regular rider—as differentiated from the casual rider. Fourteen of twenty companies having a cash fare of 25¢ or higher had a token fare sturcture. Of the fourteen, only four had a token fare less than authorized in Order No. 245.

It should be recognized that a mere comparison of the monetary level of fares is of little value without a correlation with other factors such as the length of ride, geographical coverage, and standards of service such as availability of service, schedule frequency and condition of equipment.

The Commission is of the opinion and finds that the margin of return allowed in Order No. 245, both in dollars and operating ratio, was fair and reasonable, and should be affirmed.

THEREFORE, IT IS ORDERED that the findings and conclusions set forth in Order No. 245, as explained and detailed herein, be, and they are hereby, affirmed.

BY DIRECTION OF THE COMMISSION

DELMER ISON
Executive Director

B-121

BEFORE THE

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

ORDER NO. 564

SERVED January 26, 1966

In the matter of:

Application of D. C. Transit System, Inc., for authority to increase fares	Application No. 344 Docket No. 101

APPEARANCES:

Harvey M. Spear, Edmund L. Jones, Manuel J. Davis, Leon G. R. Spoliansky, William T. Reynolds, Samuel M. Langerman, Attorneys for D. C. Transit System, Inc., Applicant.

Leonard N. Bebchick and *Stanley O. Sher,* Attorneys for: Leonard N. Bebchick, Linda Sher, Daniel Gottlieb, Samuel Krafsur, Protestants; D. C. Federation of Civic Associations, Protestant; The Democratic Central Committee of D. C., Intervenor.

Thomas Lyon, pro se, Protestant.

Diana K. Powell, pro se and Republican Precinct 46, Protestants.

L. Paul Smith, for the Deanwood Civic Association, Protestant.

Fred Meissner, pro se, Protestant.

Lester McKennie, Sharlene Kranz, and *William Higgs,* pro se, Protestants.

Herman Sternstein, Attorney for Local Division 689, Amalgamated Transit Union, AFL-CIO.

Russell W. Cunningham, General Counsel, Washington Metropolitan Area Transit Commission.

Before Charles M. Duke, Chairman, Edward D. Storm, Vice Chairman, H. Lester Hooker, Commissioner.

On September 17, 1965, D. C. Transit System, Inc., filed an application seeking authority to increase fares for the transportation of passengers within the District of Columbia, within the State of Maryland, and between the District of Columbia and points in Maryland, all of which territory lies within the territorial jurisdiction of the Washington Metropolitan Area Transit Commission ("Commission").

By its application, which was accompanied by appropriate tariffs, D. C. Transit System, Inc. ("Transit"), seeks authority from this Commission to increase its charges for tokens from four tokens for 85¢ to four tokens for $1.00; increase its District of Columbia cash fare from 25¢ to 30¢; increase its D. C. Downtowner Minibus fare from 5¢ to 10¢; increase its Maryland cash fare for the first zone of coverage, or any part thereof, from 15¢ to 20¢; increase its fare for express route service between Maryland and the District of Columbia by 5¢; increase the fare for the Capitol Hill express service from 50¢ to 60¢; increase by 5¢ the cost of joint fare tickets; increase its 10-ride commutation ticket by 50¢ (5¢ increase per ride). At the same time, applicant filed an additional tariff requesting to increase the cash fare for its special operations between points in the Washington Metropolitan Area and D. C. Stadium from 50¢ to 60¢. No changes are proposed in the school fares or the fare for the Silver Rocket Express.

The proposed fares were suspended until February 5, 1966, pursuant to Section 6(a), Article XII, Title II of the Washington Metropolitan Area Transit Regulation Compact ("Compact").

Informal protests to the proposed increase in fares were filed by a number of individual transit riders, all of whom were given an opportunity to testify at a special evening hearing called for this purpose. Thirty-four of

such individuals appeared and made statements for themselves or organizations which they represented. Formal protests were filed by certain individuals, groups and organizations, as shown under the "APPEARANCES" of this Order. The Central Democratic Committee was permitted to intervene after the proceeding had commenced, and *only* after Transit voluntarily withdrew its objections.

Pursuant to notice, duly given in accordance with the Commission's Rules and Regulations, public hearings on the application commenced on November 8, 1965, and continued intermittently for fourteen (14) days, through and including January 5, 1966.

Transit presented the testimony of its First Vice President, Morris Fox; its Vice President and Comptroller, Parker C. Peterman; its Vice President for Maintenance and Operations, Alfred E. Savage; V. A. McElfresh of H. Zinder and Associates, Inc; Seymour S. Mintz of Hogan and Hartson, Attorneys at Law; Robert R. Nathan of Robert I. Nathan Associates, Inc.; Thomas F. Airis, Director of the D. C. Department of Highways and Traffic; and Walter J. Bierwagen, International Vice President of the Amalgamated Transit Union. The Commission's staff presented the testimony of its Chief Accountant, Melvin E. Lewis, and its Chief Engineer, Charles W. Overhouse. The only other party to present formal testimony at the hearing was intervenor, Democratic Central Committee, which presented the testimony of Edgar H. Bernstein.

The combined testimony of these expert witnesses have produced a record containing 2,253 pages of oral testimony and some 127 exhibits.

The principal reason advanced by Transit for fare relief was increased operating expenses brought on by a new, one-year labor contract, which, it asserted, would add over $1.5 million to its labor costs in the calendar year 1966. In its application Transit used the actual operating results for the twelve-month period ended June

30, 1965, as the test period for purposes of projecting future results. The calendar year 1966 was used by Transit for the future test period. The Commission's staff also used the identical test periods, both past and future, as used by Transit.

AUDITING

The numerous adjustments made by the staff in the recorded operating expenses of Transit, the great majority of which went uncontested, point up a problem which has concerned the Commission for some time.

The magnitude of the adjustments required, both as to number and the amount thereof, indicate very forcibly that an abnormal situation exists. The abnormal situation stems from Transit's affiliation with numerous companies engaged in many diverse, non-transit actitivites. These non-transit activities permeate the duty assignments, to some extent, of almost every administrative and executive employee of Transit. We have no fear but what the staff, in making its adjustments, generally resolved all doubt "in favor of the ratepayer," but such practice tends to penalize Transit rather than solve the problem.

We urge Transit to consider, voluntarily, separating completely its transit and non-transit activities so that Transit's personnel will not be involved in non-transit functions.

LABOR CONTRACT NEGOTIATIONS

One of the intervenors alleged that the new labor contract, effective November 1, 1965, was not entered into as result of arms-length bargaining, but did not offer any evidence in support of such allegation. While the Commission will not interfere with arms-length bargaining, it will in all cases satisfy itself that such bargaining took place. The Commission is satisfied, after reviewing the

evidence, that this contract was negotiated on an arms-length basis.

PROJECTIONS

Pertinent to any discussion of future projections of Transit are two items which have been issues in every prior rate case involving Transit, namely, Acquisition Adjustment Account and Reserve for Track Removal and Repaving.

Acquisition Adjustment Account

The Acquisition Adjustment Account reflects the net effect of two basic purchase transactions. One involved the acquisition of the Old Capital Transit Company on August 15, 1956, reflected in an original difference between purchase price and aboriginal cost per-the-books in the amount of $10,339,041.19. The second acquisition adjustment reflected the purchase of the Inter County Bus Company in April of 1960. In this instance the purchase price exceeded book value by $82,397.00. In the latter case, it should be noted, the Public Utilities Commission of the District of Columbia, on August 17, 1960, directed that this $82,397.00 acquisition adjustment be charged off on a monthly basis over the remaining life of D. C. Transit's franchise, namely, sixteen years and four months to August 15, 1976. At issue here in this case is the effect of WMATC Order No. 385, dated September 11, 1964, the effect of which was to cease the ten-year amortization rate on the $10,000,000 credit acquisition adjustment as of January 1, 1964, and to begin a different rate of amortization, gauged to spread the remaining balance in the acquisition adjustment account over the remaining 151.5 months left in the franchise period of D. C. Transit System, Inc. Therefore, for the years 1964 and 1965, Transit's books showed a credit to income in the amount of $199,561.06 per year for this item, instead of the annual amount of $1,033,904.12 previously

in effect. Actually, since tax adjustments were made to the acquisition adjustment account based on settlements pertaining to the original purchase transaction between Capital Transit and D. C. Transit System, Inc., the annual amortization rate under the original ten-year plan would have been hereafter $959,793.60.

As was pointed out in Order No. 385, if Transit were permitted to continue amortizing the then remaining balance of the acquisition adjustment account at the rate of approximately $1,000,000 per year, the entire balance would be completely written off by mid-1966. The Commission further noted in its Order that if this credit balance were permitted to be exhausted in this manner, the effect would be that Transit's annual income would suddenly drop at the drastic amount of approximately $1,000,000 a year. Consequently, at a time when the action of the Commission would have no adverse effect on the fare structure of Transit, from the ratepayers' point of view, the Commission acted to avoid this eventuality. One of the intervenors made the argument that the Commission acted injudiciously in revising the amortization rate of the acquisition adjustment account. The fallacy of this argument is highlighted by intervenor's own contention that the present balance of almost $2,000,000 (which would have not been there except for the Commission's action), should now be amortized over the next two years. If the Commission were to follow this suggestion, it would be creating the same situation which it corrected in 1964.

In light of the above we fail to see any merit in intervenor's argument that the rate of amortization of the acquisition adjustment account should be adjusted.

Track Removal and Repaving

Since August 16, 1956, Transit had been accruing some one million dollars a year into a Reserve for Track Removal and Repaving. By the end of 1962, the total accrued to this Reserve was over six and one-half million

dollars and the amount charged against the Reserve as of that date was something under two million dollars. Accordingly, by Order No. 245, served April 12, 1963, the Commission forbade any further accruals to this Reserve on and after January 1, 1963, pending further orders of the Commission. The balance in the Reserve, unexpended as of December 31, 1962, was $4,814,250. Expenditures since 1963 for Track Removal and Repaving have now brought this balance down to a substantially lower level than it was on January 1, 1963.

Staff testimony developed a maximum estimated excess of track removal requirements for the period ending December 31, 1966, over available balance in the Reserve for Track Removal at June 30, 1965, in the amount of $153,074.43. The staff had adjusted the Reserve Account for errors and other corrections totaling $287,114.00 of which $65,042.00 was unchallenged by Transit. The remaining $222,000.00 involved provision for D.C. income taxes. Staff testimony also provided for budgeted and unbudgeted contracts estimated to be billed to D.C. Transit by the Director of the D.C. Department of Highways and Traffic, covering the period from July 1, 1965, to December 31, 1966, including a $34,000 adjustment not included in the Highway Department's forecast but actually billed to Transit after July 1, 1965.

The $222,000.00 adjustment on account of D. C. income taxes was made to conform with the "net of taxes" treatment instituted by the Public Utilities Commission in its Order No. 3592. If the charges to the account were generated on a "net of taxes" basis, and continued thus over a seven-year period as long as debt adjustments were required, consistency demands that, now that the time has arrived for the credit entries, the procedure set up by the PUC be continued to its logical conclusion. In order to expedite the carrying out of this directive, Transit is directed to remove the amount of $222,072.22

from the Reserve for Track Removal by crediting such account; the contra-debit will be to an account entitled "Deferred Tax Charges—Track Removal Costs."

The Commission likewise will, in its forthcoming certification, for the fiscal period ended August 31, 1964, covering the various certifications pertaining to D.C. Transit System, Inc., charge as an operating expense for that period five percent of the net cost of track removal and repaving as incurred during the year 1963 and the first eight months of 1964. The staff, and Transit as well, should continue the entire "net of taxes" treatment of track removal expenditures until the entire amount of $222,072.22 is offset. The Commission takes note of PUC Order 3592-59, page 5 thereof, which reads as follows:

> . . . to the extent that the provision for track removal and repaving is currently disallowed for tax purposes, the resulting increase in income taxes should be charged to the account Reserve for Track Removal and Repaving, so that provision is made on a "net of taxes" basis. Under this procedure the customers will not be currently charged with the total estimated cost of track removal and repaving without the off-setting benefit of the related reduction in income taxes.

It is clear to the Commission that Transit has been on notice since PUC Order No. 3592-59 was issued in 1959, and has, in fact, kept its books on a "net of taxes" basis since 1956. Consistency demands that this "net of taxes" treatment be continued until the charges that were built up between 1956 and 1962 are completely offset by credits to the deferred tax account and debits in the proper amount, as indicated above, to the operating taxes for the years in which actual costs were incurred.

The Commission finds that the charges and credits indicated in staff testimony are proper and that, to the extent that projected costs and expenditures are accurate, there will be an excess of track removal require-

ment over available balance in the Reserve for Track Removal in the amount of $153,074.43. However, the Commission, aware of the great practical difficulties in the past of forecasting track removal cost and noting the testimony with regard to the considerable slippage possibilities in timing the projects, is of the opinion that the balance in this Reserve is adequate to cover projected costs for 1966.

The basic fact to be faced here for the long run is that the liability of Transit to remove and cover track is contained in Section 7 of the Act granting the franchise to Transit the cost of such removal and covering work has been and remains the final liability of the ratepayer. Since August 15, 1956, all accruals for this work have been charged to and paid by the ratepayer. The difficulty now is that what was once considered a ten-million dollar project is now not even subject to exact estimate as to ultimate cost. Much track has been covered rather than removed. Such cover may be utilized efficiently for ten, twenty or more years in the future, with no need ever to disturb the underlying track. However, technically, at some future period, even twenty years hence, if the need occurs to dig up the street and remove that track it is Transit's liability and responsibility to pay for it; this is another way, of course, of saying it is the ratepayers' liability.

The sum and substance of the foregoing discussion is that by the end of 1966 the balance in the Track Removal Reserve will be nil under the current track removal program. Anticipating such an event at some future date, the Commission stated in Order No. 245:

> The Commission will keep abreast of the Track Removal and Repaving program of the District of Columbia and if, at any time, because of a change in the program, there appears to be a need for resumption of accruals to this reserve, the Commission will act accordingly.

As the financial burden of the track removal pro-

gram falls upon the ratepayer, consideration should be given to having Congress relieve the applicant of this indefinite future obligation.

In the absence of a drastic change in the track removal and repaving program of the District of Columbia in 1966, the Commission will have no other alternative but to allow Transit, effective January 1, 1967, to resume accruals to this Reserve in an amount of between $800,000 and $1,000,000 per year for the next three or four years.[1] This additional cost to the ratepayers, in terms of token fares, before calculating the tax effect, is equivalent to a fare increase of approximately a cent and a quarter (1-1/4¢).

This liability was formalized as far back as 1942. There is no question but what at that time a long-range program consisting of sporadic projects, was contemplated. Subsequent legislation requiring conversion to an all-bus system has, however, had the effect of creating what could be called, in comparison, a crash program. The phasing out of rail operations was accelerated, the only brake upon it being the congressional mandate to tie the conversion program to the highway construction program.

A combination of events has caused both programs to be accelerated. The impact, while slow in developing, has been tremendous, creating a strenuous burden on the transit rider and on Transit. As the transit rider has borne the financial burden up to this point, we feel our recommendation to the Congres is both timely and equitable.

In order that the ratepayer may be saved from the inevitable consequences, we again recommend that Congress, immediately, relieve Transit, and in consequence, Transit's riders, of this obligation.

---

[1] Transcript, page 1484.

PROJECTION OF REVENUES AND EXPENSES FOR 1966 UNDER PRESENT FARES

The Commission has considered carefully the testimony of both Transit and the staff, including the rebuttal testimony of Transit, in regard to projection of revenues and expenses for 1966 under present fares. Transit agreed with the majority of the staff adjustments. The major adjustments brought into issue are as follows:

1. *Revenue Projections.* Transit estimated gross operating revenues in 1966 to be $32,698,744 at present fares. In arriving at this estimate it used the operating revenues for the twelve months ended June 30, 1965, as a base and made certain adjustments as indicated below:

Operating Revenues	Actual 12 Months Ended June 30, 1965	Adjustment	Future Annual Period at Present Fares
Passengers	$29,837,656	$ 717,422	$30,555,078
Charter Bus	1,648,511	200,000	1,848,511
Government Contracts	126,124	(9,266)	116,858
Station and Vehicle	108,168		108,168
Other	(30,878)	101,037	70,159
TOTAL Operating Revenues	$31,689,581	$1,009,193	$32,698,774

The staff, in estimating regular route passenger revenues for 1966 at present fares, used passengers transported and operating revenues for the twelve-month period ending June 30, 1965, as a base; projected passengers for the calendar year 1965 based on historical trends, and then estimated the number of passengers to be transported and the amount of revenue to be received by continuing or adjusting the trends through 1966. The staff estimate of operating revenues for 1966 under present fares was $33,363,694.00.

The major differences between the estimates of Transit and staff in revenues for 1966 were in regular route and

charter revenues. The staff projected $253,797 more in regular route revenue and $410,000 more in charter revenue than estimated by Transit.

Transit did not take issue with the additional charter revenue projected by the staff.

In an attempt to rebut the staff's testimony, Transit testified that it transported 137,352,588 regular route passengers and received $30,133,559 in regular route revenue plus an estimated $50,000 for token ticket write-off-adjustments for a total of $30,183,559 in 1965. The staff estimated revenue passengers for 1965 but did not project passenger revenues. Had it estimated revenues for 1965 based on its passenger projections, the revenue figure would have been $30,233,432. This figure represents $49,873 more revenue than Transit reported for 1965.

Transit also offered into evidence rebuttal testimony comparing passengers and revenue between 1964 and 1965. The staff had insufficient time to verify the figures submitted due to the lateness of filing by Transit. However, our investigation of Transit's rebuttal testimony after the termination of the hearings, reveals that Transit made several errors, resulting in an understatement of its revenues for 1964 by $352,178, the corrected figure being $29,656,635, and not $29,304,457 as testified to by Transit.

The Commission favors the method used by the staff in the projection of future revenues. However, considering the July through December, 1965, experience of Transit (not available to the staff or Transit at the commencement of the hearings), which was used by Transit in rebuttal testimony, it appears that the staff's estimate of future revenue may be high. Regular route revenue for 1965, as testified to by Transit, was $30,183,559. The regular route revenue in 1964 was $29,656,635. This indicates a 1.8% revenue increase, 1965 over 1964.

Considering all facts before it, the Commission finds that under present fares Transit will receive $30,726,863 in regular route revenue in 1966 which represents a 1.8% increase over 1965.

Based on all evidence and facts, the Commission finds that under present fares the Total Operating Revenues for 1966 will be:

Regular Route	$30,726,863
Charter	2,258,511
Government Contracts	116,858
Station, Vehicle & Other	179,450
Total Operating Revenue	$33,281,682

2. *Injuries and Damages.* Transit contends, by its testimony and exhibits, that the amount to be credited to the Reserve for Injuries and Damages should continue to be 4% of gross revenue. This would amount to $1,331,267 in 1966 under present fares.

The main purpose of an Injuries and Damages Reserve is to reserve a sufficient amount of money to adequately satisfy the settlement of claims for injuries and damages that are pending.

The staff presented the following testimony concerning Injuries and Damages Reserve:

YEAR	CREDITS	CHARGES	CUMULATIVE AVG. CHARGES	ADJUSTED OUTSTANDING RESERVES FOR OPEN CLAIMS	BALANCE END OF YEAR
1960	$1,241,254	$1,086,173	$ ---	$1,704,868	$2,006,015
1961	1,261,445	1,329,356	1,207,764	1,682,496	1,938,104
1962	1,262,190	1,269,726	1,228,418	1,750,300	1,930,568
1963	1,234,874	1,372,087	1,264,335	1,604,695	1,793,355
1964	1,266,530	1,246,001	1,260,669	1,570,342	1,813,884

The balance at year end has always exceeded the adjusted outstanding reserves for open claims. The staff estimated that $1,300,000 is a reasonable amount to be credited to the Reserve in 1966. This amount of credit should leave a sufficient amount in the Reserve balance to meet the adjusted outstanding reserves for open claims.

The Commission finds that an annual amount of $1,300,000 is reasonable to be credited to the Reserve. The Commission is of the opinion that one-twelfth (1/12) of such amount should be credited to the Reserve each month commencing January 1, 1966. This amount may be changed by order of the Commission for good cause.

3. *Certain Executive Salaries and Bonuses.* The Commission has consistently disallowed bonus payments to executives as an operating expense for rate-making purposes; the retention by Transit of the option to pay or not to pay these bonuses removes these charges as proper charges for rate-making purposes. The Commission accepts the salary adjustments made by the staff except it will recognize and allow for rate-making purposes the full salaries paid Mr. Flanagan and Mr. Chalk for 1965, being satisfied that they each fall within the discretionary limits of management.

It should be pointed out that if Transit follows the Commission's suggestion as to the separation of transit and non-transit activities, then the need for the staff's recommendations with regard to salaries in the future will have been removed.

4. *Cost-of-living Increases.* The Commission will give full force and effect to the actual cost-of-living increases which have taken place up to the present time, which include the 1/2¢ increase in October, 1965, and the 2-1/2¢ increase in January of 1966.

5. *Limousine Driver Wages.* On this record, the Commission finds no reason why any labor costs, and costs associated with labor, involved in driving limou-

sines, should be borne, in any percentage, by the ratepayer. Management has been uninformed as to the extent to which make-up time is utilized in limousine and charter work. It behooves Transit to address itself immediately to the problem of optimal utilization of every hour of labor available to it.

6. *Adjustment for Maintenance Costs.* Included in operating expenses are accounts 1304, 1305, 1306, 1315 and 1316, the so-called "maintenance expense accounts." Account 1304 consists of labor and material costs for air-conditioned units and maintenance of bus bodies, account 1305 consists of labor and material costs for chassis maintenance, account 1306 consists of rental cost of tires and tubes which is computed on a mileage basis, account 1315 consists of motor fuel costs, and account 1316 consists of lubricant costs.

In comparing the maintenance expense for 1966, Transit estimated that it would be the same as the twelve-month period ended June 30, 1965 ($4,249,452), plus increases due to increased costs of operating additional air-conditioned buses, additional miles on Silver Rocket Service, additional miles in charter business, increases in payroll and fringe benefits, minus savings due to reduction in price of fuel and other minor adjustments.

In computing maintenance expense for 1966, the staff estimated that it would be the same as the twelve-month period ended June 30, 1965 ($4,249,452), plus increases due to additional miles on Silver Rocket Service, additional miles in charter business, increases in payroll and fringe benefits, minus savings due to reduction in prices of fuel and savings due to adding 200 new buses operating at maintenance costs of approximately 6¢ per mile which replaced old buses operating at maintenance costs of approximately 25¢ per mile.

It is the Commission's view that Transit did not make proper adjustments to the maintenance costs for the twelve-month period ended June 30, 1965, in estimat-

ing maintenance costs for 1966. The most important adjustment should have been the savings in cost of operating 200 new buses versus 200 old buses, scheduled for replacement. The Commission is of the opinion that costs will be reduced when 200 old buses operating at maintenance costs of approximately 25¢ per mile, are withdrawn, and new buses which will operate at maintenance costs of somewhere between 6¢ and 8¢ per mile, are added to the fleet.

The staff estimate appears low, due, at least, to bus-assignment difficulty; on the other hand, Transit's original and rebuttal data fails to recognize any savings on account of the new buses in the latter half of 1965 and 1966 — in fact, Transit persisted in adding $41,000 to cost of maintaining air-conditioning units. Transit also failed to consider savings which may result from projected consolidation of operating divisions in early 1966.

The Commission is not unaware of the fact that in the last rate case involving D. C. Transit, Transit, by dint of careful management economies, was able to reduce operating costs in 1963 substantially below those projected in Order No. 245. Accordingly, the Commission accepts as reasonable the estimated maintenance costs projected by the staff.

7. *Estimated Cost of Legal and Witness Fees for Current Rate Case.* On rebuttal, Transit added $81,000 as estimated costs of processing this rate case. The Commission will allow this as a necessary and proper operating cost of 1966.

8. *Research Project for Bus Shelters.* The Commission takes judicial notice of a new research project scheduled for 1966 and 1967, aimed at the design and construction of bus shelters. The estimated cost of Transit's share in this demonstration project to be conducted in cooperation with the Housing and Home Finance Agency is $50,000 over a two-year period. Accordingly, the Commission will allow an additional expense for 1966 in the amount of $25,000.

9. *Adjustment of Fare on Downtown Minibus.* The Commission cannot ignore the obvious inequity in and inadequacy of the 5¢ fare now in effect on the downtown Minibus line. This rate of fare was instituted only as part of a research program subsidized jointly by Transit, the District of Columbia Government, Downtown Progress, and the Housing and Home Finance Agency. Now that the subsidy arrangement and the experimental phase have been concluded, it is manifestly unfair to continue the experimental rate. None of the participants in the Minibus Project contemplated the continuation of the fare at 5¢; Transit, for reasons of its own, has chosen to wait until this proceeding to ask to raise this fare. The Commission will permit Transit to change the Minibus fare to the more reasonable level of 10¢.

In taking this action, the Commission will recognize an increase in projected revenues for 1966 in the amount of $57,100, being the latest estimate in the record by Transit for this unit of service.

DEFICIENCY IN DEPRECIATION RESERVE

The deficiency in the depreciation reserve account of Transit was recognized by Order No. 381, served September 11, 1964. This Order, which was based on a study by the Stone & Webster Service Corporation, as of August 15, 1963, established individual depreciation accounts for each class of assets as of January 1, 1964. It also established rates of depreciation to be applied to each class of assets. In establishing the new accounts reflecting depreciation reserves for each class of property, it was determined that the reserve for depreciation heretofore carried on the books was deficient in the amount of $1,223,099.04. The new reserves for depreciation were established on the books as of January 1, 1964, and the $1,223,099.04 deficiency was placed in a suspense account. Since the date of that Order the suspense account has been adjusted for salvage credits re-

alized from the sale of obsolete equipment. The balance remaining for disposition in this case is $1,099,627.

In Order No. 245, served April 12, 1963, discussion was had by the Commission on the item of depreciation reserve against buses. In that Order the Commission said:

> The testimony further developed that by May, 1961, the District of Columbia Public Utilities Commission, with the completed reserve requirement study in hand, determined that this over-accrual on buses had been substantially offset by under-accruals on other classes of company property, and by the unrecovered costs on rail facilities as projected to August 15, 1963.
>
> If the Court's decision is implemented, it further appears that the refundable revenues allocable to excess depreciation on buses will have to be allocated to rebuilding a deficient depreciation reserve.
>
> Here again the record in the 1960 rate case did not include the final results of the reserve requirement study by Mr. Ingoldsby because it had not been completed. The completed study, as subsequently noted by the District of Columbia [Public] Utilities Commission, indicated that any excess depreciation accrual on buses had been substantially offset by under-accruals on other classes of property and rail facilities.

Based on these statements from its 1963 Order, the Commission is inclined to transfer any such deficiency, such as we are here concerned with, to the Court-Ordered Reserve. The logic of charging this deficiency off against the Court-Ordered Reserve lies in the fact that just as the credits in the Court-Ordered Reserve represent a build-up over a period of years prior to the current year, so does the depreciation reserve deficiency represent a build-up of deficiency in past years' depreciation charges, to be made up in the current or future periods. It is clear to the Commission that this deficiency in depreciation charges should equitably be made

up by charges to the ratepayer, but as to the techniques of preferring to accomplish this by a charge against a Court-Ordered Reserve in lieu of charging a particular period's profit and loss account, is merely a matter of semantics. Thus, whether the deficiency in the depreciation reserve which concerns us now is written off directly or the operating statement of a particular period or periods, or whether it flows first through the Court-Ordered Reserve, the impact on the rate-paying public is still the same. It is to this impact which the Commission addresses its concern. And if the Commission can dispose of this deficiency in one yearly period without causing an increase in fares, it appears to the Commission that this is the propitious time in which to make such an adjustment.

The Commission, as will be noted, has determined that the deficiency in this depreciation reserve can be charged to the year 1966 without causing a fare increase, and thus the Commission will close out this account against the operating revenues of 1966.

Now the Commission addresses itself to the question as to whether or not the ratepayers should be responsible for the entire $1,099,627 available for this disposition. The Commission, after considering all the testimony on the subject in this case, agrees with the logic and the conclusion that $293,459 of this deficiency should be shared by the buildings and properties which contributed to this deficiency, and which have, since August 15, 1963, been placed below the line. Therefore, the remaining amount of $806,168 will be utilized at this time as a charge above the line. Transit is directed to close out the balance in this deficiency account by crediting the account in the amount of $1,099,627 and contra-debiting the depreciation expense account (above the line) for 1966 in the amount of $806,168, and depreciation expense (below the line) in the amount of $293,459.

INCOME TAXES (INVESTMENT TAX CREDIT)

Neither Transit nor staff exhibits flowed through any benefits that might accrue to Transit under the investment tax credit provisions of the Internal Revenue Code. This is in accordance with Commission action in rate cases which were processed through this Commission since the 1964 Revenue Act was passed. In each of three major rate cases decided by this Commission since February 1964, when the 1964 Revenue Act became law, the Commission's policy has been to comply with the intent of Congress as expressed in Section 203(e) of the 1964 Revenue Act. The pertinent provision of that section follows:

> It was the intent of Congress in providing an investment credit under Section 38 of the Internal Revenue Code of 1964, and it is the intent of the Congress in repealing the reduction in basis required by Section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to taxpayer shall, without the consent of the taxpayer, use --
>
> (1) in the case of public utility property . . .
>
> (2) . . . any credit against tax allowed by Section 38 of such code, to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method.

The Commission finds no reason at this juncture to change its policy with respect to treatment of the investment tax credit. However, any benefits flowing to Transit from these investment tax credits will not be ignored by the Commission in any cash flow considerations.

PROJECTED OPERATING STATEMENT FOR 1966

The findings of the Commission in relation to the operating forecast projected for 1966, incorporating all of the foregoing adjustments, are summarized in the following statement:

Gross Operating Revenues, with no change in fares	$33,281,682
Additional revenues to be generated by increase in downtown Minibus fares	57,100
Total Gross Operating Revenues	$33,338,782
Operating Revenue Deductions; as adjusted	$32,641,725
Net Operating Revenue, before income taxes	$ 697,057
D.C. Income Tax chargeable for Track Removal Costs, in conformity with "net of taxes" procedures	48,700
Net Operating Revenue, after income taxes	$ 648,357

MARGIN OF RETURN

The Compact requires the Commission to "prescribe just and reasonable" fares. A just and reasonable rate is one that assures that all the enterprise's legitimate expenses will be met and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to provide both the form and substance of financial strength and stability. Sections 6(a)(3) and (4) of the Compact indicate that the Congress and State legislatures intended that the operating ratio method should be the primary test of the reasonableness of Transit's fares. We turn now to a determination of what is a proper margin of return, that is, the difference between operating revenues and expenses, for this particular proceeding.

Two expert witnesses testified at length in connection with a proper margin of return for Transit, one of the witnesses testifying for Transit and the other for protestant-intervenor. The staff's Chief Accountant [2] testified as to the problems involved in rate-making, and as to why the operating ratio method is a better tool than the return-on-investment procedure in arriving at rates of return for the transit industry.

Transit's expert witness testified as to his opinion, based on a study he had made, of what would constitute a fair and reasonable rate of return for Transit. His study included a review of: (1) rates of return, on both the operating ratio and rate base methods, allowed by regulatory authorities and courts in cases involving not only transit companies, but telephone companies, electric companies, and gas companies; (2) yields on government obligations and on public utility bonds for the purpose of comparison with the cost of debt capital to Transit; (3) financial data concerning the capital structures and rates of return of Transit and other privately owned transit companies, natural gas transmission companies, natural gas distribution companies, and Class A and B electric utilities; (4) comparisons of the market price trend of the common stock of D. C. Transit System, Inc., of Delaware, with market price trends of the common stock of other regulated utilities; (5) dividend pay-out ratios of Transi' in comparison with privately owned transit companies and other regulated public utilities; (6) comparisons of the growth in gross plant of Transit with the growth in gross plant of other privately owned transit companies; (7) price-earnings ratios of other privately owned transit companies and other reg-

---

[2] The role of the Commission's staff in rate cases, as set forth in Order No. 245, served April 12, 1963, is to objectively scrutinize and analyze all data having a bearing on the case; this precludes the staff from assuming a partisan or adversary posture. The staff therefore makes no recommendations as to fair return.

ulated utilities for the purpose of comparison with the price-earnings ratios of Transit; (8) data showing a comparison of revenue passenger history of Transit with that of other privately owned transit companies; and finally, (9) the history and projection of Transit's income, rate base, equity and dividends from 1956 through 1966.

Mr. V. A. McElfresh, Transit's expert witness, testified that the interest rates of Transit averaged 5.75% on an annual basis as of June 30, 1965. He further testified that interest rates on government obligations are generally considered to be representative of pure interest cost with a minimum of risk. His study revealed an upward trend in the yields on public utility bonds from 1960 through June, 1965. He concluded that the effect of this upward trend of interest rates would be to increase the cost of borrowing money for all utilities, and Transit must generate increased earnings to pay these increased interest rates if its financial structure is not to deteriorate. He also compared the average interest cost of other transit companies with the interest cost of Transit, and concluded that the current 6% being paid by Transit on equipment purchases is a higher interest rate than is being paid by any other transit company for which data was available. Cross examination of his testimony brought out, however, that his study included a period of time too far in the past and did not include sufficient detail for us to give this factor significant weight. While he has not convinced the Commission that Transit is currently paying a higher interest rate than the average transit company for equipment purchases, Mr. McElfresh attempted to justify a higher interest rate because of the high debt ratio of Transit. He then went on to state that a higher debt ratio results in a higher interest cost because a debt investor runs a greater risk in a company having a high debt ratio in comparison with a company having a much lower debt ratio. The witness introduced and discussed a compilation of comparative data of the capital structure of regulated utilities other than transit com-

panies. This was used in his testimony as a basis for comparison of the capital structure of Transit with other privately owned transit companies. He stated that return on total capital and return on equity capital comparisons clearly indicate that investment in the transit industry is considerably less attractive than investment in any of the other groups of utilities displayed in his exhibits. The witness reviewed operating ratios allowed by regulatory commissions and courts in transit rate cases during the years 1955 to date. Of the 24 opinions and orders reviewed, 15 were utilized by the witness. The operating ratios ranged from a low of 91.6% to a high of 96.5%. In his opinion, this range of operating ratios establishes a yardstick to aid in establishing the fairness of the operating ratio to be determined for Transit in this proceeding. His testimony also included the discussion of the use of the operating ratio method as a basis for the regulation of utility rates and contained the observation that this method is used almost exclusively in the fixing of rates for the transportation industry. The major reason for this, he stated, is the wide difference in the relationship of gross operating revenues to capital investment. Each dollar of capital investment in a transit company will produce well beyond a dollar in gross revenue. The comparable ratio in the other regulated utilities is different, in that generally, an investment of three to five dollars is required to produce one dollar of gross revenue. He noted that another substantial factor was the fact that labor cost constitutes a greater percentage of the operating expenses in the transit industry than in other regulated utilities. He gave the opinion that this points to the great significance of a small percentage increase in cost on the profits and financial well being of transit companies.

The witness also made a study and analysis of rates of return on system rate base allowed by regulatory authorities and courts; it included regulated utilities and other industries as well as the transit industry. He noted that transit companies have been allowed a higher return

on rate base than have other regulated utilities and drew the conclusion that this was the result of the much greater risks in the transit industry than in other regulated industries.

This witness also presented evidence relating to price-earnings ratios of selected companies, concluding that the investor confidence in Transit is substantially less than in other regulated utilities. He concluded that this demonstrates the need for increased earnings.

He gave evidence that Transit is experiencing a growth in plant which is contrary to the practice in the industry and thus highlights the risk to the equity owners, such expansion justifying a higher rate of return.

The witness testified that it was his opinion that the average return on the rate base of 5.25% in the future annual period is definitely on the low side. He also concluded that a return of 20.97% on common stock equity is likewise low, taking into consideration the high debt ratio of Transit and the risk associated in the transit industry generally and Transit in particular. The witness also mentioned the added risk faced by Transit as a result of the new subway to be built within the next 5 to 7 years, which is well within the life of Transit's franchise, and which would operate, according to the witness, in direct competition with Transit along all of its arterial routes.

It was the opinion of this witness that a return of 25 to 30 percent on the equity capital of Transit would be entirely reasonable. In arriving at this opinion, he noted that the risk of investment in Transit is more than double the risk of investment in other regulated industries, and therefore the rate of return for Transit should reflect a greater return for this risk. Such a return, he concluded, was necessary to enable Transit to maintain its annual dividend pay-out of $500,000 a year. He stated that the market place assumes now the continuation of this same amount which has occurred every year since

1960. It was his opinion that if the annual pay-out was not continued, the adverse effect on the market value of the stock of the parent would be considerable, and the financial stability of Transit would deteriorate in the eyes of the financial community. All of these factors led the witness to believe an overall return of not less than 10% on the rate base of Transit is necessary to accomplish and arrive at a reasonable rate of return. Finally, he concluded a return on gross operating revenues of 8% would be a fair and reasonable return, and that Transit's projected margin, with new fares as applied for, was well within this range.

The intervenor-protestant expert witness, Mr. Bernstein, testified as to what in his opinion would be a fair rate of return. This witness determined a fair rate of return on the basis of cost of capital, which cost was derived by combining the applicant's past cost of debt capital and past cost of equity. The latter was arrived at from a study of earnings-price ratios and dividend-price ratios of selected transit and other regulated utility companies. It was his opinion that the risks attendant on Transit were embraced within his cost of capital study and analysis. Based on his study, this expert witness concluded that a fair cost of equity capital for Transit falls in the range of 12 and 13 percent; he recommended that the Commission allow Transit a return on equity capital of that amount in setting fares in the future period. Mr. Bernstein based his calculations on an equity investment of approximately 4-1/2 million dollars, resulting in a return of $550,000-$600,000. He also recommended that the Company be permitted to earn the aggregate dollar amount required to service its debt in 1966, which was estimated to be $957,000. Thus, his recommendation was that a fair return to Transit should be between $1,500,000 and $1,550,000.

The intervenor's expert witness recommended a gross operating revenue margin of return of 4.5% to 4.75%, which equates to an operating ratio of 95.25% - 95.5%

and, on a base of $33,000,000, a return of about one and a half million dollars.

The staff's Chief Accountant, Melvin E. Lewis, explained the basic difference between fixing rates for fixed plant companies and transit companies in the following language:

> . . . The return on rate base of the fixed-plant companies should ordinarily be lower percentagewise than the return on the lower fixed-plant of motor carriers. The rates of return on gross operating revenue show up in a striking fashion when we compare the margin of return on gross operating revenue of the fixed-plant companies with that of the motor carrier; the return on gross operating revenues of the fixed-plant companies is substantially higher than the rate of return on gross revenue of the motor carrier. This is the normal situation, because as the District of Columbia Court of Appeals indicated this past summer in the D. C. Transit rate case, the risk in the motor carrier industry inheres in the operating costs whereas the risk in the fixed-plant companies inheres in the plant investment. Therefore, we are constrained to exercise more attention to the return on rate base for fixed-plant companies and on return on gross operating revenues for the motor carriers.

Mr. Lewis went on to explain why the operating ratio theory of rate making has replaced the return on investment theory almost universally as a tool for rate making in the motor carrier industry in the following language:

> It is generally recognized that the theory was proposed as a means of overcoming the deficiencies which have been attributed to the general use of the ratebase theory as applied to the motor carrier industry. The term 'operating ratio' may be broadly defined as the relationship between expense and gross revenues, or, as referred to in the Compact, a return on gross operating revenues.
>
> The reason for adoption of the operating ratio theory for the motor carrier industry was the fact that

the investment or ratebase theory ceased to meet the acid test of reasonable earnings.

The average motor carrier has a relatively small investment compared to total operating expenses. The investment of the motor carrier is largely confined to relatively short-lived rolling stock. In view of the practice of equipment leasing prevailing in the industry, it is not uncommon for a motor carrier to provide adequate service with little or no investment. Consequently, there is frequently little correlation between booked investment and the standard of service rendered to the public.

Any attempt to relate a consistent and uniform rate of return to investment or rate base in the motor carrier industry is met, more frequently than not, with many frustrations. While a given rate of return on investment might produce an adequate return for one carrier, the same return could very well be inadequate to pay the cost of debt of another carrier. Furthermore, since the rate base of a given carrier is subject to rapid and major fluctuations, the rate of return will also fluctuate widely even though the net earnings remain constant.

The industry feels immediately the impact of economic aberrations such as strikes, increased labor costs, decline in patronage, and even changes in the weather.

The net earnings of a motor carrier are drastically influenced by every minor percentage change in either projected revenues or expenses. A percentage return based solely on the much smaller rate base investment is generally inadequate to compensate the investor for the risks inherent in such fluctuations.

The motor carrier industry, in general, and the passenger transit industry in particular, is sensitive to serious competitive forces, primarily due to the convenience and comfort of the private automobile. Contrarywise, the fixed-investment type utility enjoys a substantial monopoly in its sphere of operations.

The above factors, peculiar to the motor carrier industry, and the need to devise an appropriate

> means to compensate the carrier for its inherent risks, lead to the abandonment of the rate base theory in favor of the operating ratio theory.
>
> The percentage spread (between revenues and expenses), is generally fixed to allow the carrier a sufficient number of dollars to cover, among other things, (1) interest charges; (2) withdrawals or dividends large enough to pay a return on investment; (3) a contribution to surplus which may be used for modernization; (4) a cushion for cyclical swings in business; and (5) the time lag between wage and other expense increases and the effective date of fare relief.
>
> Since it is not feasible to assign a dollar value to each of the varied and sundry risks inherent in the motor carrier industry, the accepted approach is for the regulatory commission to establish a reasonable percentage spread which will compensate the carrier for its investment, its cost of money and the numerous other risks inherent in the business. The Compact suggests that a ratio spread of at least 6-1/2% . . . shall not be considered unreasonable.

None of the expert witnesses disputed the requirement under the Compact that the Commission must utilize the "operating ratio" as the primary method of rate-making; they differed only as to the margin of return — the difference between revenues and expenses.

Section 6(a)(3) requires the Commission:

> . . . [to] give due consideration, among other factors, to the inherent advantages of transportation by such carriers; to the effect of rates upon the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable such carriers, under honest, economical, and efficient management, to provide such service.

Section 6(a)(4) also instructs the Commission:

> [A]s a matter of legislative policy . . . in order to assure the Washington Metropolitan District of an

> adequate transportation system operating as private enterprises, the carriers therein . . . should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As an incident thereto, the opportunity to earn a return of at least 6-1/2 per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

The Court of Appeals for the District of Columbia Circuit in a prior case[3] involving Transit laid down guidelines in the following language:

> A "just and reasonable" rate is one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability."

The rate-of-return testimony of these three expert witnesses must be related in some measure to gross operating revenues, Transit's rate base and stockholders' equity.

We have already determined that projected gross operating revenues for Transit for the year ending December 31, 1966, will be $33,338,782.

Transit projected a rate base at December 31, 1966, in the amount of $28,208,541. The staff projected Transit's rate base as of the same date to be in the amount of $27,105,665, and also projected an average rate base for the future annual period in the amount of $26,219,357. The intervenors and protestants did not present any rate base evidence. One of several reasons for the difference between Transit and staff estimates of rate base is the treatment accorded the balance of the acquisition adjust-

---

[3] D.C. Transit System, Inc. v. Wash. Metro. Area Transit Commission, 350 F.2d 753, 778 (1965).

ment account. Although the acquisition adjustment account once had a major impact in rate base calculations, the balance in the account is now small enough to be of little consequence. For purpose of this case, and as a check for determining the reasonableness of earnings allowed Transit in the year 1966, we find that a rate base of $27,000,000 is accurate enough; technically, an averaged rate base for a future period is much more valuable than a year-end figure, but there were many adjustments in Transit's projected rate base which were not clearly developed in Transit's testimony nor included in the staff's projection. The only saving factor is that the entire range of difference, from a $28,000,000 high to a $26,000,000 low, related to an earnings figure of $2,000,000 will cause a disparity of only a trifle more than 1/2 of 1% in the rate of return on rate base.

There was considerable testimony on the subject of stockholders' equity in Transit. During the hearing, the Commission asked for, and received from its Chief Accountant, a breakdown of assets and liabilities per Transit's books as of that date, showing which were involved in Transit activities and which were not. There is no question but that total Transit assets of $27,082,392.14 minus total transit liabilities and reserves of $25,827,-407.09 produces an equity figure, attributable to transit operations, of $1,254,985.05. However, the Commission will utilize in succeeding calculations the overall equity balance of $4,562,825.07, considering that the net assets thus represented of a non-transit nature are available at all times for, and in furtherance of, the fiscal needs of Transit.

Transit's debt-equity ratio is approximately 80-20. It is quite obvious that this relationship is far above the norm. On the other hand, analysis of the components of the rate base of Transit reveals a very modern fleet and plant. In fact, the high quality of the assets in the rate base of Transit allays any fears that the small amount of stockholders' equity may interfere with Transit's responsibility for rendering good service to the public.

Transit has acquired 739 new, air-conditioned buses since 1958 at a capital cost of $24,000,000, and is presently under orders from the Commission to purchase an additional hundred such buses each year. The real criterion as to the quality of Transit's equipment, and consequently its service, is not revealed in terms of stockholders' equity but largely in terms of Transit's rate base. Although it may be immaterial to the bus rider, in terms of service, whether debt capital or equity capital is used to purchase the bus he rides in, the important point is that this Commission must assure the bus rider that the fare he pays is not burdened with an unreasonable cost of capital. There was much discussion in the record concerning the debt-equity ratio. In fact, this Commission has in the past been critical of Transit's method of financing, and has expressed concern over the increasing ratio of debt to equity. This solicitude does not represent a fear on the part of the Commission that a return based on the operating ratio theory of rate making will result in an excessive return to Transit on its book equity; indeed, this record is clear, and every witness testifying on the subject agreed that debt capital is cheaper than equity capital. The main concern of the Commission in relation to this entire problem is that the high debt ratio might, at some time, adversely affect the financial stability of Transit, which could result in higher costs for debt capital or the inability of Transit to borrow money altogether. At the present time Transit is paying 6% interest on its debt to acquire new buses. The expert witness for protestant-intervenor testified that a return of between 12% and 13% on equity represents a reasonable return for Transit. Transit's expert witness indicated that a much higher return was just and reasonable. In order to fully appreciate the testimony to the effect that debt capital is cheaper than equity capital one has only to relate the lowest percentage of return on equity recommended in this case (12%) to Transit's outstanding debt of $15,877,096. If this debt capital were in fact equity capital, Transit would then be entitled to a return on total eq-

uity in the amount of $2,452,790. Cost of debt capital would amount only to one-half of this sum. Added to this would be the traumatic effect on the income tax liability, which, having no interest expense deduction available, would increase by some $450,000 per year, equivalent to a reduction in the return on gross operating revenue of 1-1/3%. Our main concern thus is that Transit continue to provide adequate and convenient transportation service with modern equipment and at reasonable fares. The uncontradicted testimony establishes that Transit is performing service at the lowest basic fares of any comparable private bus operation in the United States. That it is giving reasonable service is reflected in its revenue passenger statistics. Indeed, the projected increase in riding for 1966 over 1965 is one of the reasons why the Commission will be able to hold the fares at their present level. This upward trend of riding is occurring at a time when the industry generally is continuing to suffer a declining trend in riding. In the final analysis, then, we are primarily concerned as to whether or not Transit is meeting its obligations to the public at the minimum costs. If it can meet this obligation to the public with debt capital cheaper than equity capital, then it is not appropriate to criticize a high percentage return on a low equity, if in the final analysis the cost to the ratepayer is less.

We do not want to be misunderstood. Transit's debt-equity ratio should not be allowed to deteriorate further. The entire matter, however, of return on equity must be kept in proper context.

Every witness testifying on the subject agreed that in determining Transit's margin of return the Commission must include an allowance to cover Transit's interest on debt. Transit's cost of debt in 1966 will be approximately $960,000.

Transit has paid an annual dividend of $500,000 since 1960 and the testimony tends to show that the market place

assumes the continuation of such dividend. The expert witness for the protestant-intervenor did not agree with Transit as to the requirement for overall earnings, but he saw an advantage to continuing annual dividend payments at the $400,000 level, being the amount flowing through to the holders of the Delaware Company's stock.

We are of the opinion that the intervenor's cost-of-capital method of determining a fair rate of return for Transit in this proceeding is not wholly applicable to the transit industry generally and to Transit in particular. Mr. Bernstein stated that any conclusions under his approach must still be subject to the application of good judgment; and many factors which might influence one's judgment were not fully developed at the time of his testimony.

Having determined that the margin of return must include $960,000 as cost of debt and $400,000 to $500,000 for annual dividend, we must now determine how much additional money is required to enable Transit to maintain a sufficient surplus to cover contingencies and to assure the financial stability of Transit. The following contingencies must be considered by the Commission in arriving at a judgmental figure for Transit for 1966:

> Admittedly, the Commission has been conservative in its estimates for future revenues and expenses. In fact, the difference between the net operating income projections of the Commission and Transit amounts to more than $800,000. The Commission feels that in prescribing rates under the operating ratio method it should be careful not to over-estimate revenues or expenses since the rate of return is directly geared to these items. If we, even inadvertently, should include margins of error, in the estimated operating revenues or expenses, we would be allowing a return on such errors. The great possibility of error in estimates and projections, a very real contingency, thus is better given weight here in the margin of return allowed than above the line where the effect would be compounded.

Unless Congress acts to remove Transit's obligation to remove and/or repave old streetcar track, the possibility exists that Transit might incur considerable expense over and above the amount which remains in the track removal reserve in 1966. There is also the risk that the track removal program could be accelerated during the future period.

It is most difficult to evaluate the effect that the recently enacted subway legislation will have on the confidence of the investor in Transit, hence the effect on market price of its stock and Transit's ability to attract new capital.

With reference to revenue projections, a mere 1% drop in passenger revenues under that projected by the Commission could result in a reduction of approximately $300,000 in collections in 1966.

We cannot ignore the fact that the present labor contract expires on November 1, 1966, and that there is a possibility that the Company will incur additional labor costs for the last two months of the year.

One factor which might ordinarily ameliorate some of the risks discussed above is the schoolfare subsidy. Public Law 87-507 requires that calculation of the return for determining eligibility be limited strictly to "mass transportation operations in the District of Columbia." All certifications by this Commission under Public Law 87-507, thus far, have developed rates of return for D. C. mass transit operations only which were much greater than the actual system-wide rates of return. It is the view of the Commission that Transit is not likely to qualify in 1966 for any subsidy under the schoolfare subsidy law, irrespective of the level of overall earnings.

Upon consideration of the above factors, and the numerous other normally anticipated problems, including the forecasting of charter revenue, management economies, or difficulties to be encountered on account of organiza-

tion changes, plant relocation and the myriad other day-to-day problems, which multiply the difficulties of prognostication, it appears to the Commission that a margin of some $550,000 to $650,000 is a fair and reasonable allowance to provide Transit as a cushion over and above interest and dividends to assure some measure of financial stability for Transit in 1966, under extant circumstances.

The Commission therefore finds that a margin of return above operating expenses in the amount of about $2,000,000 is fair and reasonable for 1966, and will enable Transit to service debt, pay reasonable dividends, and retain a sufficient surplus to cover various contingencies. This margin of return will produce a rate of return of 7.4% on Transit's rate base, discussed heretofore. Considering the numerous risks attendant upon Transit's operations, when such a return is related to other regulated utilities without similar risks, we feel that 7.4% return on Transit's rate base is low. In view of the standard of service provided by Transit, we consider that the margin of return authorized herein provides a fair return.

COURT-ORDERED RESERVE

As a result of appeals from the rate case decisions of the District of Columbia Public Utilities Commission of March 2, 1960 (Order 4631), and January 18, 1961 (Order 4735), the United States District Court for the District of Columbia established a *Special Court-Ordered Reserve*. The Reserve was established in September, 1963, with a credit of $2,350,000, offset on the books by a charge to earned surplus account in the amount of $500,000, a charge to depreciation reserve in the amount of $1,000-000 and a charge against the reserve for track removal and repaving in the amount of $850,000. Since that time, expenses authorized by the Court, and paid out of the

Court-Ordered Reserve, have reduced the balance now available in this Reserve to $2,166,933.21. The Court Order which established this Reserve stated that this account ". . . will be available for utilization, within its discretion, by the Commission having regulatory authority . . . provided such discretion is exercised consistently with the purpose of benefiting transit users in any rate proceedings pending or hereafter instituted concerning D. C. Transit System, Inc."

We interpret the mandate of the Court to mean that before Transit can be authorized to collect additional revenues through higher fares, the Court-Ordered Reserve must first be depleted. We know of no more direct way of benefiting the transit rider than by using the funds in this Reserve to help avoid an increase in fares.

As will be noted elsewhere in this Order, Transit is expected to realize net earnings, under present fares, in 1966, in the amount of $648,357.[4] As noted above, the funds available in the Court-Ordered Reserve amount to $2,166,933.21. Restoration of the depreciation reserve deficiency in the amount of $806,168 can be accomplished by removing this amount from the Court-Ordered Reserve, leaving a balance in the Court-Ordered Reserve of $1,360,765.21.

The Commission, in the discussion of the margin of return to which Transit is entitled, has concluded that Transit is entitled to net earnings in the amount of approximately $2,000,000 in 1966. Since Transit is expected to experience net earnings of $648,357 under present fares in 1966, it must be allowed additional return in the approximate amount of $1,350,000. Credits approximating this amount, remaining in the Court-Ordered Reserve, are now available to Transit. If the entire amount available in the Court-Ordered Reserve is used for this pur-

[4] This assumes a Minibus fare of 10¢.

pose, Transit's net earnings in 1966 are projected to be $2,009,122 or a return on gross operating revenues of 6.03%.

Accordingly, the Commission is now utilizing this Court-Ordered Reserve for the purpose for which it was intended by the Court. The Commission recognizes that the transfer of the credit in this Reserve to the net operating profit line of Transit for 1966 does not of itself generate operating cash for the use of Transit; it also is cognizant of its responsibilities under regulatory law to utilize the credits in this Reserve in lieu of operating income for the purpose of directly benefiting the ratepayer. This Reserve represents a reservation of excess revenue funds collected in some past years, and the ratepayer cannot be called upon to furnish these funds a second time, nor should Transit expect a second supply of cash funds for this item.

Much testimony and cross-examination revolved around the taxability of the Court-Ordered Reserve if treated, or not treated, in a particular fashion on the books of Transit. The Commission is aware of the fact that Transit's expert on this matter testified only that if a portion of the Court-Ordered Reserve were ordered to be credited through the income statement as a type of income or used as a means to increase income (referring to the $850,000 originating from the track removal reserve), this mere procedure of flowing the adjustment through income rather than back through the reserve for track removal "might well cause the Internal Revenue Service to attempt to tax such amount as income."[5] The expert witness at no point was willing to discuss the taxability or non-taxability of the item under any accounting procedure, but limited his testimony absolutely to discussing only the fact that in his opinion the transfer of $850,000 of the Court-Ordered Reserve credit to operating income would "give rise to a

[5] Exhibit 70, p. 4.

question of their taxability."[6] None of the cases cited by this expert, and included in the record, appeared specifically relevant to the problem involved here.

The fact remains, however, that there has been no positive testimony as to the taxability of all or part of the Court-Ordered Reserve credit, although there has been negative testimony on this subject. The further fact remains that Transit has been and remains on a flow-through basis for income tax purposes as far as this Commission is concerned in the establishment of rates of fare. Thus, no injury can accrue to Transit from any future tax decisions affecting Transit due to action by this Commission. All tax liabilities developed over the years, from year to year, by action of the Internal Revenue Service, are passed through the accounts and paid for by the ratepayer. The Commission is not unmindful of the fact that just in the past year the tax liabilities of Transit's predecessor were settled, involving tax and interest costs to Transit as well as to its predecessor; these tax adjustments were taken up on the books and will, in due course, be borne by the ratepayer through the acquisition adjustment account. The Commission also knows that Transit's tax returns for the period beginning August 16, 1956, through the year 1964, have not been finally accepted by the Internal Revenue Service; there remain several major items involving serious tax consequences that have not yet been finalized.[7]

---

[6] Exhibit 70, p. 5.

[7] Federal income taxes, skimming off 48% of net profit, have a major impact on utility rates — requiring revenues of twice the magnitude which would be required to arrive at a fair return if income taxes were not involved. The operation of the income tax on privately-owned utility companies is thus regressive, resulting in the ratepayer indirectly, but definitely, paying the income tax. It is clear to this Commission that the patrons of privately-owned utilities are at a great disadvantage compared to the patrons of publicly-owned utilities when the former are liable for corporate income taxes whereas the latter are exempt.

[Continued, next page]

The Commission finds it proper at this time to transfer the entire credit balance in the Court-Ordered Reserve to 1966 retained earnings.

In allowing Transit to transfer the funds in the Court-Ordered Reserve to its Retained Earnings Account, the Commission must emphasize that should there develop a substantial disparity between net operating income in 1966 and the amount projected in this Order, so that the net operating income experienced in 1966 is substantially greater than the amount provided for in this Order, the Commission reserves the right to reduce the amount transferred. For instance, if Transit fails to place in service on or before June 1, 1966, 100 new air-conditioned buses, an appropriate amount would be restored to the Court-Ordered Reserve Account. It is just noted, in passing, that the depreciation expense projected for 1966 includes $153,650 applicable to such new buses and consideration also has been given to interest payments in the amount of $113,094, covering the purchase of these new buses, and principal payments in the amount of over $160,000 for the financing of these buses.[8]

This Commission feels very strongly that the elimination of the income tax on mass transit carriers would be a major step toward accomplishing a comparability of fare structures between privately-owned and publicly-owned carriers; it would correct a major inequity in that the transit rider in the Metropolitan District is being penalized by having to cover the income tax assessed the privately-owned carriers.

We would like to see this Congress enact legislation to correct this inequity on the ratepayer; this would be in line with other forward-looking tax measures already enacted and being considered by Congress.

[8] Transit's entire depreciation schedule for its current fleet of buses hinges on the purchase each year of 100 new buses.

CASH FLOW

The Commission is sympathetic with the cash management problems which will face Transit due to the need to flow into income, credits from reserves set up in the past and containing no cash for present use. Immediately following is a statement showing sources and application of funds for Transit if 1966 projections prevail. This statement indicates that there will be sufficient cash coming through the fare box, even if the acquisition adjustment entry is excluded, to cover all of the forecasted principal and interest payments required in 1966, assuming the purchase of 100 new buses as of June 1, 1966. In preparing this statement, two items were omitted and should be commented upon in passing.

One of the items omitted is provision for possible investment tax credit rebate, as well as any other tax refunds, whether they be carried back to past years or carried forward to future periods. Even though investment tax credit is not being considered in the determination of rates in accordance with the intent of Congress as expressed in the 1964 Tax Code, the presence of cash refunds generated by the investment tax credit or tax loss carrybacks is certainly a major factor in studying Transit's cash flow problem. This is definitely a source of funds for Transit. The Commission is advised of the possibility of tax refunds for 1966 from carrybacks to 1963 of $296,000 and to 1964 of $196,000; this depends, of course, on the effect of 1965's tax return, when filed, which may generate more tax refund possibilities. Investment tax credits available in 1965 were over $750,000 but the technicalities involved in the utilization of this credit in 1965 and in 1966 make it impossible to arrive at any definite or accurate forecasts.

The second item omitted, of course, is the cash dividend which Transit has been paying during past years. This would indicate a need for Transit to switch to a stock

dividend, which would have the dual advantageous effects of alleviating the cash problem for 1966 and of increasing the equity investment in Transit by the investors.

SOURCES AND APPLICATION OF FUNDS-D.C. TRANSIT SYSTEM, INC., PROJECTED FOR 1966

Projected Net Operating Revenue excluding non-cash income tax provisions	$ 697,057
Add: Non-Cash Charges for depreciation expense	2,812,704
Net Funds Generated	$3,509,761
Servicing of Loans:	
Principal	$(2,344,000)
Interest	(956,945)
Excess of Funds	$ 208,816
Exclusion of Acquisition Adjustment Entry from Income	$ (194,516)
Pure Cash Flow Excess	$ 14,300

The following statement incorporates the final determinations of this Commission for Transit for 1966:

OPERATING STATEMENT FOR D.C. TRANSIT SYSTEM, INC. (D.C.) PROJECTED FOR 1966

Gross Operating Revenues	$33,338,782
Net Operating Revenue, after income taxes	$ 648,357
Special Adjustments for 1966:	
Deficiency in Reserve for Depreciation, closed out	(806,168)
Balance in Court-Ordered Reserve, closed out	2,166,933

Net Transfer to Retained Earnings for 1966	$ 2,009,122
Return on Gross Operating Revenues ($2,009,122 ÷ $33,338,782)	6.03%

In arriving at its decision, the Commission has carefully weighed and evaluated all testimony and exhibits. It is neither possible nor feasible to set forth every detail of evidence adduced or argument made in this proceeding. Nor is it possible to detail in every respect our judgmental evaluation of those factors. We have evaluated the evidence and arguments within the previously enumerated statutory guidelines. Nevertheless, the vision of the Commission must not be limited to the horizon of a particular proceeding. The effects of our decision herein must also be considered in the context of tomorrow as well as today. The end result of our decision must be the movement of the greatest number of passengers at the lowest possible fare. Without the roadblock that a fare increase always creates through passenger resistance, the trend of increased passenger usage of mass transit will continue. Hopefully, through increased cooperation among all segments of our Metropolitan District, including the operator and the public and its governmental bodies, counterbalances can be attained to offset the spiralling fiscal demands that the future portends. Increased usage of public transportation facilities benefits everyone. We take this opportunity, then, to issue a call for assistance and cooperation. We are confident that the operator, the public, civic and governmental units will respond. If the community at large will unite in a great endeavor to stimulate the use of mass transit, we will reach the multiple goals we all want — reasonable fares, good service, and manageable traffic conditions on our streets.

The Commission finds that the existing fares, except for the Downtowner Minibus service, as augmented by the Court-Ordered Reserve, are just and reasonable in that they will meet the revenue requirements of Transit.

The Commission further finds that the rates and charges proposed are unjust and unreasonable in that they would produce revenues in excess of the financial requirements of Transit; except that the proposed fare for the Downtowner Minibus service is just and reasonable, and should be granted.

THEREFORE, IT IS ORDERED:

1. That the application of D. C. Transit System, Inc., for increases in fares as set forth in Supplement No. 1 to WMATC Tariff No. 29 and Supplement No. 2 to WMATC Tariff No. 28, be, and it is hereby, denied, except as hereinafter provided, and said supplements be, and they are hereby, rejected.

2. That the application of D. C. Transit System, Inc., for an increase in fare for the D.C. Downtowner Minibus service from five cents (5¢) to ten cents (10¢) be, and it is hereby, granted, effective February 6, 1966. An appropriate supplement shall be filed on or before that date.

3. That the accounting treatments set forth hereinabove shall be complied with as described.

BY DIRECTION OF THE COMMISSION:

DELMER ISON
Executive Director

LIBRARY
SUPREME COURT, U. S.

In The

Supreme Court of the United States

October Term — 1968

No. 783

Office-Supreme Court, U.S.
FILED
JAN 17 1969
JOHN F. DAVIS, CLERK

D. C. TRANSIT SYSTEM, INC.,

Petitioner,

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB and WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,

Respondents.

On Petition for a Writ of Certiorari to The United States Court of Appeals for The District of Columbia Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

LEONARD N. BEBCHICK
STANLEY O. SHER
BEBCHICK, SHER & KUSHNICK
919 - 18th Street, N. W.
Washington, D. C. 20006

Counsel for Respondents
Williams, Trask, Democratic Central Committee of the District of Columbia, Bebchick, and Gottlieb

INDEX

	Page
QUESTION PRESENTED	1
STATEMENT	2
ARGUMENT	8
Introduction	8
The Issue of Fair Return	9
The Relief Granted	10
CONCLUSION	13
APPENDIX	A-1

CITATIONS

Cases:

Bebchick v. Public Utilities Comm., 318 F.2d 187 (D.C. Cir. 1963), *cert. den'd.*, 373 U. S. 913 (1963) . . . 3, 6, 8, 12

Busby v. Electric Utilities Union, 323 U. S. 72 (1944) . . . 8

Capital Transit Co. v. Public Utilities Comm., 213 F.2d 176 (D.C. Cir., 1954), *cert. den'd.*, 348 U. S. 816 (1954) . . . 12

D. C. Transit System, Inc. v. Washington Metropolitan Area Transit Comm., 350 F.2d 753 (D.C. Cir., *en banc*, 1963) . . . 2, 10

District of Columbia v. Pace, 320 U. S. 698 (1944) . . . 8

Page

Federal Power Comm. v. Tennessee Gas Transmission Co., 371 U. S. 145 (1962) 3, 10

Fisher v. U. S., 328 U. S. 463 (1946) 8

Payne, et al v. Washington Metropolitan Area Transit Comm. (consolidated) Nos. 20,988 & 21,029, ___ F.2d ___ (D.C. Cir., Oct. 8, 1968) 3

Universal Interpretive Shuttle Co. v. Washington Metropolitan Area Transit Comm., ___ U. S. ___ (No. 19, Supreme Court, November 25, 1968) 10

In The

Supreme Court of the United States

October Term – 1968

No. 783

D. C. TRANSIT SYSTEM, INC.,

Petitioner,

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB and WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION,

Respondents.

On Petition for a Writ of Certiorari to The United States Court of Appeals for The District of Columbia Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

QUESTION PRESENTED

The question is whether the United States Court of Appeals for the District of Columbia Circuit having jurisdiction under the Washington Metropolitan Area Transit

Compact ("Compact") to review orders of the Washington Metropolitan Area Transit Commission ("Commission") exceeded its powers as a court of review when (1) it set aside two rate-making orders of the Commission (then superseded by subsequent rate-making orders) on the grounds that the orders were unsupported by necessary findings and reflected arbitrariness in failing to consider and apply statutory standards previously enunciated by the Court; and (2) as an incident to such ~~order~~ action and in the exercise of judicial discretion, it ordered partial restitution of amounts received by the utility under the unlawful orders set aside.

STATEMENT

On April 8, 1965, the court below remanded to the Commission for further consideration its Order 245 which had authorized a 1963 increase in the fares charged by D.C. Transit System, Inc. ("Transit"). *D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission,* 350 F.2d 753 (D.C. Cir., *en banc,* 1965) hereinafter "Transit I").[1] The court found that the Commission had described its deliberations and conclusions on the fundamental question of fair return "in terms of stock generalizations which serve only to frustrate, rather than illuminate, judicial review." (Appendix, A-7). As the court was confronted with "the Commission's failure to provide us an adequate basis for knowing why it did and what it did", it directed the Commission upon remand "to determine the margin of return over and above operating expenses that Transit should be allowed." (Appendix, A-10). Neither the Commission nor Transit sought to obtain certiorari.

---

[1] For convenience the relevant portions of the Court of Appeals opinion in Transit I are set out in the Appendix ("Appendix") at the close of this brief. These portions are also found at 350 F.2d 777-781.

The Commission had set Transit's return by a purported application of the "operating ratio" method of ratemaking an approach prescribed by the Compact (Page A-2 of Petitioner's Appendix, hereinafter cited "Petit. App.") and whose proper application has been approved by the court below both prior and subsequent to this litigation.[2] The court undertook to disabuse the Commission of the belief that such a ratemaking method might properly be applied simply by plucking any particular operating ratio figure from the air. The court took great pains to enlighten the Commission as to the lawful predicate for a proper application of the operating ratio standard in setting rates and as to the various areas of factual inquiry required to support necessary findings. This brief will be foreshortened and the Court's comprehension of the Petition facilitated by a recitation here of what the Court of Appeals said in 1965:

> "We do not quarrel with the Commission's conclusion that Congress intended that the operating ratio method should be the primary test of the reasonableness of Transit's fares. But the language that appears in its order strongly suggests that it misunderstood what that test entails. In *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591,602 (1944), the Supreme Court enunciated what is now a fundamental principle of rate regulation: "Under the statutory standard of 'just and reasonable'

---

[2] *Bebchick v. Public Utilities Commission*, 318 F.2d 187 (D.C. Cir., 1963), *cert. den'd.*, 373 U. S. 913 (1963); *Payne, et. al v. Washington Metropolitan Area Transit Commission* and *D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission (Consolidated)*, Nos. 20,988 and 21,029, ___ F.2d ___ (D.C. Cir., October 8, 1968).

it is the result reached not the method employed which is controlling." (Emphasis added.) The Court went on to point out that, in balancing investor and consumer interests, it is essential to consider the capital costs of the enterprise. 320 U.S. at 603. Here, unlike the *Hope* case, Congress has specified what method of rate making the Commission should employ, but in so doing it did not relieve the Commission of the necessity of making the kind of inquiry that must be made if the statutory standard is to be complied with. A "just and reasonable" rate is one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability. A rate fixed without particularized reference to these needs does not satisfy any standard of rate making of which we are aware, including that of return on operating expenses. The operating ratio method does not make such an inquiry irrelevant; indeed, it was in part the failure of rates established by the rate base method to cover the capital costs of most motor carriers that led to its adoption. ***

We know from this figure of 95.13 only that the legitimate operating expenses found by the Commission – and we accept that legitimacy in this case – account

for all but 4.87 per cent of the total revenues expected to be realized from the approved fare structure. We need to know more than we have been told about why the Commission thought this was the appropriate margin. The fixing of that margin is not in truth a process so greatly different from what is done in determining rate of return in traditional rate-base rate-making. There also the gross revenues allowed are to cover legitimate operating expenses in the first instance – and something more. That something more is the sum of money needed to attract the capital, both debt and equity, required to insure financial stability and the resulting capacity of the utility to render the service upon which the public depends. To determine that sum entails inquiries and findings–judgmental as the latter may often be because rate-makers must be prophets of the future as well as historians of the past–into such things as the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2." (Appendix, A-5 *et. seq.*).

Upon remand the Commission without further proceedings issued a supplementary order (No. 563) affirming its earlier determination. On the same date it issued Order No. 564 arising out of a subsequent rate proceeding wherein the Commission increased Transit's allowable return. The company was permitted to realize the increased return by a withdrawal from a court-ordered reserve[3] in lieu of an increase in fares.

Your respondents sought review of both Orders and the appeals were consolidated. The Court of Appeals on October 8, 1968, sitting *en banc* and acting unanimously set aside the Orders and directed that partial restitution be made in respect of fares collected under Orders 245 and 563 and amounts withdrawn from the court-ordered reserve under Order 564. The court below rejected not only the level of fair return established by the Commission in both proceedings, but also a variety of expense allowances and accounting adjustments. The implementation of the decree of restitution will require a variety of factual determinations to be made by the Commission on remand. Petitioner here seeks certiorari only in respect of the court's action in setting aside the Commission's determination in Order Nos. 245, 563 and 564 as to the level of fair return which Transit should be permitted to earn and in awarding restitution.

In passing upon a question of fair return in its decision for which certiorari is sought, the court below stated:

---

[3] The reserve was established as a means of providing restitution to transit users for previously authorized unlawful fare increases. *Bebchick v. Public Utilities Commission*, 318 F.2d 187, 203-204 (D.C. Cir. *en banc*, 1963), *cert den'd.*, 373 U.S. 913 (1963).

> "The case now before us, however, is quite different. The Commission, once again, does not advance a rational basis for its determination of rate of return – despite the opportunity afforded it to do so, after we had enunciated the applicable principles and emphasized the need for findings. Moreover, it now appears affirmatively that at no time in this proceeding has the Commission made the investigations and the resolutions essential to a legitimate exercise of its authority to prescribe just and reasonable fares. Since we cannot escape the conclusion that the Commission's approval of the fare increase was based upon a mistaken view of its responsibilities in setting rates under the operating ratio method, we hold that Order Nos. 245 and 563 must be set aside." [Footnotes Omitted] (Petit. App., B-26, B-27).

In a similar vein, the court elsewhere in its opinion observed that despite the explicit guidelines which it earlier had set forth, it searched the Orders in vain to find any of the vital and essential findings or any manifestation of inquiry into any of the pertinent considerations called for. Moreover, it saw little in the way of particularized reference to matters discussed in the remand opinion. (Petit. App., B-7, B-24, B-82).

The court below then determined in an exhaustive analysis of precedent that no further remand was warranted particularly in view of the fact that the rate orders in question had been superseded and the Commission did not possess retroactive ratemaking powers. (Petit. App., B-28 through B-31). Finally, the court, consistent with earlier practice and in accordance with a detailed analysis of legal precedent, awarded partial

restitution of certain amounts received by Transit under the Orders set aside. (Petit. App., B-32 through B-41).

ARGUMENT

A. Introduction

1. The best response to the Petition is the opinion of the court below. This is not only because the opinion is exceptional in its length, detail and extensive analysis of every issue presented, but essentially because the petitioner's characterization of what the court did bears little relationship to what in fact its opinion says. We respectfully direct the attention of this Court to the applicable portions of the opinion below. (Petit. App., B-1 through B-41; B-82 through B-101).

2. The opinion below is that of an *en banc* Court of Appeals and represents the *unanimous* determination of the sitting judges. It is the third such *en banc* review determination of agency action in the setting of fares charged by Transit.[4] The issues involved are routine and the court's action is simply another instance of setting aside arbitrary agency action for want of adequate findings and failure to adhere to statutory standards. Petitioner asks the Court to become involved in regulatory aspects of bus transportation in the District of Columbia under a Compact limited in application to the Washington Metropolitan area and effective upon only a few bus companies of which Transit is by far the largest. This is precisely the type of local D.C. subject matter with which this Court repeatedly has declined to become involved. *Fisher v. U.S.*, 328 U.S. 463, 476 (1946); *District of Columbia v. Pace*, 320 U.S. 698, 702 (1944); *Busby v. Electric Utilities Union*, 323 U.S. 72, 74-75 (1944).

---

[4] *Bebchick v. Public Utilities Commission*, cited *supra*, Ftn. 2; *Transit I*, cited *supra*, p. 2.

B. The Issue of Fair Return

1. Petitioner suggests that the decision of the court below as to the legal requisites for a proper application of the operating ratio standard of ratemaking possesses national importance and implication. The fact is that to our best knowledge no Federal statute, including those applicable to the Interstate Commerce Commission, specifies as does the Compact the employment of an operating ratio method of ratemaking. Moreover, the definitive views of the Court of Appeals on this subject (Transit I, cited, *supra,* p. 2) have been in the public domain for almost four years and we are unaware of a single instance in which these views in any way have impeded or adversely affected the effective discharge of ratemaking duties by any regulatory agency. Given the considerable time which has elapsed since the decision in Transit I, we would have expected that Transit would have been able to provide some factual basis to support its unwarranted speculations.

2. As far as concerns the operating ratio standard, we understand the thrust of Transit's Petition to be that the court below erroneously rejected such standard. The court, of course, did no such thing. It merely reiterated and relied upon long-standing precedents – that the establishment of just and reasonable rates by whatever method must result from a determination based upon adequate findings and substantial evidence that the rate is one that covers a utility's reasonable expenses, its debt and capital costs, and yields a sufficient margin to provide financial strength and stability and is commensurate with the returns of other companies of similar risk so as to enable it to attract investors. As indicated in the Statement, the court below has approved establishment of rates by the operating ratio method when it has been properly applied (*supra,* Ftn. 2).

3. Transit errs in taking the court below to task for purportedly announcing for the first time a new and different standard – the cost of capital. But as the court

made clear (Petit. App., B-12 through B-19) and as it did in Transit I (Statement *supra,* pp. 4-5), the cost of capital is simply a relevant factor which the Commission must pass upon or provide a rational basis for rejecting. As the court stated, "It suffices to again point out that if a 'cost of capital approach' is to be dismissed as 'inappropriate' or spurned as 'not wholly applicable', it is incumbent upon the Commission to say why and to set forth for the record, through analysis and findings, the alternate method it employed to determine fair return." (Petit. App., B-88 through B-89).

4. Although not raised in any manner either before the Commission or the court below, Petitioner contends that the court erred in not approving any level of fair return established by the Commission which yields less than 6½% of gross operating revenues. That issue was fully briefed and decided adversely to Transit in Transit I (*D.C. Transit System, Inc. v. WMATC,* cited *supra,* p. 2, 350 F.2d at 758-766), a determination from which Transit did not seek the review of this Court. Petitioner's reliance upon some incidental language of this Court appearing in *Universal Interpretive Shuttle Co. v. Washington Metropolitan Area Transit Commission* (No. 19, Slip Op. p. 4, November 25, 1968) is of no avail. The question of whether the Commission is compelled by law to grant Transit any return it seeks which amounts to less than 6½% of gross operating revenues was not presented or considered in any form in that litigation.

C. The Relief Granted.

1. The balance of Transit's Petition deals with the relief granted by the court below – the setting aside of challenged Orders and the partial award of restitution. The court was well within its powers in setting aside orders which lacked adequate findings and represented a misapplication of statutory standards previously announced. The only durable protection which consumers have against

unlawful ratemaking is that the utility sustain its burden of proof in seeking higher fares and that the agency formulate an order which meets lawful standards, is rational, and is supported by adequate findings based on substantial evidence. The interest of consumers is sacrificed and the vitality of the regulatory process dissipated if rate decisions are ping-ponged back and forth between court and commission until a commission finally is able to discover language sufficient to muster judicial scrutiny.[5] The expense, delay and unsatisfactory result to consumers of such procedures would result in aborting the few consumer challenges to regulatory rulings which now are taken.

The court below, however, decided against remand on narrower ground founded on established precedent which it painstakingly reviewed (Petit. App., B-28 through B-36). As all of the Orders in question had been superseded by subsequent Commission determinations approving new schedules of fares and since the court believed that the Commission lacked the power to enter a new rate order applicable retroactively *nunc pro tunc*, it determined that a remand for further consideration was not called for. Petitioner's challenge to this ruling is represented by a one sentence assertion that the court's "reasoning is completely fallacious". (Petition p. 22). A more compelling analysis is required to justify grant of certiorari.

2. The balance of the Petition in effect challenges the authority of the court below to order restitution in

---

[5] Here, no remedy has yet been implemented for Petitioner's unlawful fare increase which occured in 1963. In cases where a utility has overcharged its users there is a public interest in effecting the remedial decree at the earliest feasible time. See *Federal Power Comm. v. Tennessee Gas Transmission Co.*, 371 U.S. 145, 154-155 (1962).

the exercise of its judicial function. The court in the circumstances presented felt restitution warranted because to permit Transit to retain the increased fares would be to give legal effect to the Commission's invalid orders (Petit. App., B-32 through B-41, B-95 through B-97).

Upon a detailed analysis of precedent,[6] the court found the award of restitution in such circumstances to be not a matter of right but a determination *ex gratia* resting in the exercise of the sound discretion by the court. Rather than awarding restitution for the full amount collected under the unlawful Orders as it had done in an earlier decision involving Transit,[7] the court directed that restitution be made only for the difference between the amounts received by Transit under the unlawful orders and the amounts of fair return which your respondents and their expert witnesses contended were fair and reasonable. In so acting, the court gave considerable weight to a subsequent Commission rate Order sustained by the court on review, which authorized a fair return to Transit quite close to that recommended by respondents in the instant litigation (Petit. App., B-41 and B-96 through B-97). The court narrowly circumscribed its action with the express caveat that it was not deciding whether in the absence of such a subsequent Commission determination, the course it decided to take otherwise would be open to it.

Contrary to Transit's assertions, the court did not undertake to determine the just and reasonable fares which Transit should be permitted to charge or to sanction for any ratemaking purposes any particular level of fare return which it should be permitted to earn.

---

[6] See cases collected in Ftn. 97 of the opinion (Petit. App., B-33); also see *Capital Transit Co. v. Public Utilities Commission*, 213 F.2d 176, 194-96 (D.C. Cir., 1954), *cert. den'd.*, 348 U.S. 816 (1954).

[7] *Bebchick v. Public Utilities Commission*, cited *supra*, Ftn. 2.

It correctly noted:

> "Our role as a reviewing court is not to make an independent determination as to whether fares fixed by the Commission are just and reasonable, but rather to ensure that the Commission, in exercising its rate-making power, has acted rationally and lawfully. (Petit. App., B-33).

The court in the exercise of the judicial function was "confronted with the necessity of formulating the criteria by which the amount of restitution is to be measured." (Petit. App., B-35). In establishing the appropriate criteria of restitution, the court was acting well within the ambit of its equity powers and was not undertaking to exercise the ratemaking power bestowed by statute upon the Commission. It merits emphasizing that – despite the claims made in the Petition – the court at no time attempted to determine what just and reasonable fares Transit should be permitted to charge or what amount of fair return it should be allowed to receive under schedules of fares lawfully established by the Commission.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

LEONARD N. BEBCHICK
STANLEY O. SHER
BEBCHICK, SHER & KUSHNICK
919 - 18th Street, N.W.
Washington, D. C. 20006

Counsel for Respondents
Williams, Trask, Democratic
Central Committee of the
District of Columbia,
Bebchick and Gottlieb

DATED: January 17, 1969

APPENDIX

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 17,953

D. C. TRANSIT SYSTEM, INC., PETITIONER,

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, RESPONDENT, ALFRED S. TRASK AND RICHARD A. WILLIAMS, UNITED STATES OF AMERICA, INTERVENORS.

No. 17,954

RICHARD A. WILLIAMS AND ALFRED S. TRASK, PETITIONERS,

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

AND

D. C. TRANSIT SYSTEM, INC., RESPONDENTS,

UNITED STATES OF AMERICA, INTERVENOR.

On Petitions to Review an Order of the Washington Metropolitan Area Transit Commission

---

Decided April 8, 1965

Mr. Harvey M. Spear, with whom *Messrs. John R. Sims, Jr., Edmund L. Jones* and *John J. Ross* were on the brief, for D. C. Transit System, Inc., petitioner in No. 17,953 and respondent in No. 17,954.

Mr. Leonard N. Bebchick for Williams and Trask, petitioners in No. 17,954 and intervenors in No. 17,953. *Mr. Harold Leventhal* also entered an appearance for Williams and Trask.

Mr. Russell W. Cunningham for respondent Washington Metropolitan Area Transit Commission.

Mr. I. Daniel Stewart, Jr., Attorney, Department of Justice, of the bar of the Supreme Court of Utah, *pro hac vice,* by special leave of court, with whom *Assistant Attorney General William H. Orrick, Jr.,* and *Mr. Lionel Kestenbaum,* Attorney, Department of Justice, were on the brief, for intervenor United States of America.

Before BAZELON, *Chief Judge,* WILBUR K. MILLER,* FAHY, WASHINGTON, DANAHER, BASTIAN,* BURGER, WRIGHT, and McGOWAN, *Circuit Judges,* sitting *en banc.*

McGOWAN, *Circuit Judge,* with whom BAZELON, *Chief Judge,* FAHY, WASHINGTON, DANAHER, BASTIAN,* BURGER, and WRIGHT, *Circuit Judges,* join:

---

* Circuit Judge Wilbur K. Miller became Senior Circuit Judge on October 16, 1964, and Circuit Judge Bastian became Senior Circuit Judge on March 17, 1965.

Nos. 17,953 and 17,954

Transit, the petitioner, and the intervenor alike attack the Commission's finding that a return of 4.87 per cent on gross operating revenues is "just and reasonable." Transit's argument essentially is that the Commission's finding is unsupported by substantial evidence, and that, in any event, a 4.87 per cent return is inadequate as a matter of law. Except for the points we have already discussed, however, Transit does not challenge the figures on which the Commission based its order, nor its estimate of the revenues Transit will earn at the fares allowed. The petitioner and the intervenor claim that the Commission relied solely, and thus erroneously, on the operating ratio method, disregarding all other criteria of a reasonable return. Specifically, they contend that the Commission mistakenly ignored the source and cost of Transit's capital requirements, the return on its rate base,[56]

[56] The PUC on two occasions resorted to the rate base method to "test the reasonableness of the rate of return computed under the gross operating revenue method . . . ." *D.C. Transit Sys., Inc.*, 38 P.U.R.3d 19, 45 (1961); see *D.C. Transit Sys., Inc.*, 33 P.U.R.3d 137, 149 (1960). While such

and the return on equity investment. They further contend that the Commission improperly relied on an earlier order of the Public Utilities Commission fixing Transit's return at 4.92 per cent.[57] And they, too, claim that the Commission's order lacks support in its findings or the evidence before it.

We express no opinion regarding the adequacy or inadequacy of the return allowed by the Commission, for we think that its order in this respect does not admit of the kind of meaningful judicial review contemplated by the statute. It appears to us likely that the Commission too narrowly conceived the scope of its inquiry under the operating ratio method, although, on this record, we can say only that the path it actually followed cannot confidently be discerned. *Colorado Interstate Gas Co.* v. *Federal Power Comm'n,* 324 U.S. 581, 595 (1945). The Commission concluded that Sections 6(a)(3) and (4) of the Compact required it to "'prescribe just and reasonable fares' based on the operating ratio theory of rate making." By virtue of Congress' mandate, therefore, it thought it was "not permitted to give significant consideration to return on equity," nor obligated to give more than "little consideration to return on [Transit's] . . . rate base." The Commission did concede that it was obligated to strike a balance between the interests of the company's stockholders

---

an exercise may sometimes be useful, it surely is not essential, and the result reached can never be conclusive. The important thing is not that the result reached by the operating ratio method be compared with that which would have been reached under some other method, but that the operating ratio method be applied rationally and intelligibly in the first instance.

[57] This objection to the Commission's use of the earlier order reflects a misunderstanding of its opinion. We think that the Commission, essentially, was simply pointing out a mathematical coincidence, namely, that the new fares would produce approximately the same rate of return as the old.

and those of the riders by assuring sufficient revenues to cover expenses and capital costs while at the same time giving weight to the need for adequate, low-cost service. But it nevertheless insisted that,

> in determining reasonable earnings under the aforementioned guide lines . . . primary consideration must be given to the operating ratio theory and . . . *only minor consideration need be given the other factors brought into issue.*[58]

We do not quarrel with the Commission's conclusion that Congress intended that the operating ratio method should be the primary test of the reasonableness of Transit's fares. But the language that appears in its order strongly suggests that it misunderstood what that test entails. In *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944), the Supreme Court enunciated what is now a fundamental principle of rate regulation: "Under the statutory standard of 'just and reasonable' *it is the result reached not the method employed which is controlling.*" (Emphasis added.) The Court went on to point out that, in balancing investor and consumer interests, it is essential to consider the capital costs of the enterprise. 320 U.S. at 603. Here, unlike the *Hope* case, Congress has specified what method of rate making the Commission should employ, but in so doing it did not relieve the Commission of the necessity of making the kind of inquiry that must be made if the statutory standard is to be complied with. A "just and reasonable" rate is one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide

---

[58] Order No. 245 (application of D.C. Transit System, Inc.), Washington Metropolitan Area Transit Commission, p. 44.

both the form and substance of financial strength and stability. A rate fixed without particularized reference to these needs does not satisfy any standard of rate making of which we are aware, including that of return on operating expenses. The operating ratio method does not make such an inquiry irrelevant; indeed, it was in part the failure of rates established by the rate base method to cover the capital costs of most motor carriers that led to its adoption.[59] An enterprise's operating ratio—the arithmetical ratio of its expenses to its gross revenues—may *suggest* that its rates are too high or too low, but whether they are too high or too low in fact depends in the final analysis on the degree of their correspondence to the items mentioned above. Rates that will produce an operating ratio of 95.13, therefore, do not possess some inherent validity, and whether they are proper in a given case requires a more detailed inquiry than the Commission here seems to have made.

We know from this figure of 95.13 only that the legitimate operating expenses found by the Commission—and we accept that legitimacy in this case—account for all but 4.87 per cent of the total revenues expected to be realized from the approved fare structure. We need to know more than we have been told about why the Commission thought this was the appropriate margin. The fixing of that margin is not in truth a process so greatly different from what is done in determining rate of return in traditional rate-base rate-making. There also the gross revenues allowed are to cover legitimate operating expenses in the first instance—and something more. That something more is the sum of money needed to attract the capital, both debt and equity, required to insure financial stability

---

[59] See NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS, 64TH ANNUAL CONVENTION, *Report of the Special Committee to Study Principles of Rate Regulation in the Motor Bus Industry* 461, 468 (1953).

and the resulting capacity of the utility to render the service upon which the public depends. To determine that sum entails inquiries and findings—judgmental as the latter may often be because ratemakers must be prophets of the future as well as historians of the past—into such things as the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2.

A change from one rate-making method to another does not, we repeat, dispense with the necessity for this kind of inquiry. And any hopeful confidence we might have that such an inquiry may have been made but not articulated is scarcely enhanced by the Commission's statements to the effect that it did not regard it as either relevant or required under the operating ratio method—an error of which the Commission, as a new agency making its first start in the rate-making field, should be disabused at the outset in the interest of avoiding future difficulties. In any event, the Commission has described its deliberations and conclusions on this fundamental aspect of the case in terms of stock generalizations which serve only to frustrate, rather than illuminate, judicial review.

We are assured by the Commission that it considered Transit's "operating and financial needs . . . and all other relevant factors" in arriving at a return of 4.87 per cent. It says that it found that the new fares would "produce reasonable net revenues to allow [Transit] . . . to service its debt, pay reasonable dividends, retain a reasonable portion

in its business and to attract investments of private investors." But what facts it relied on the Commission does not say. It had before it a statement of Transit's current annual interest charges, but it seems to have made no inquiry into the cost to Transit of borrowing money, nor to have considered what Transit's future requirements in this regard are likely to be. Transit's annual dividend pay-out of about $500,000 appears to have been treated as if it were a cost of operation, like the annual expenditure for gas and oil, with no examination of, or conclusion about, its appropriateness. There is no suggestion in the Commission's opinion that it examined earnings on investments carrying comparable risks, or took into account Transit's peculiar capitalization. The Commission does not mention, if it considered, Transit's future equipment needs, if any, and how, or on what terms, such equipment could be financed. In short, we are left with only its assurance that it did in fact consider Transit's financial needs "and all other relevant factors." We do not know nor can we divine from the record what those needs are, much less what the Commission found them to be. Under these circumstances, our review can be no more than a "perfunctory process." *Colorado Interstate Gas Co.* v. *Federal Power Comm'n,* 324 U.S. 581, 605 (1945).

Transit began its life with a capitalization in which debt was heavily, and indeed strikingly, preponderant. As noted hereinabove, this was known to Congress when it passed the Franchise Act and directed that the rates then in effect be continued. This made inevitable large returns on equity to the extent that the relatively heavy interest requirements were safely covered and the gamble on traffic levels after the resumption of operations was won. The urgency of the problem of traffic uncertainty has, however, receded appreciably into the past. Although it continues to exist to some degree by reason of the seemingly

inexhaustible enthusiasm of motorists and highway builders, on the one hand, and persistent speculation about rail rapid transit, on the other, we think the time has come for the Commission to make a careful review and analysis of the earnings experience of Transit from its inception, and of what that experience has meant to the equity owners, both by way of dividend payments and growth in book values through retained earnings. We do not see how current fare increases can properly be appraised apart from such a study, and the reflection of its results in the articulation of the Commission's decision as to the margin of revenues over expenses appropriate to today's needs, as distinct from the crisis conditions of nearly a decade ago. It seems clear that Congress, by reason of the unusual specifications contained in the Franchise Act, intended the returns to be generous, for the purpose of restoring the then shattered public transit system to some semblance of stability. But if a measure of stability has been achieved, then the present ability of Transit to attract the capital it needs on relatively favorable terms may well be superior to what it was in the earlier years of its life. At least we cannot know that this is not true, unless the Commission identifies the role thus far played by Transit's earnings in bringing about such a condition.

This matter of earnings is the more important in the light of Congress' direction to the Commission, in Section 6(a)(3) of the Compact, to give due consideration in setting fares "to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service." The Commission is thus required to see to it that the farepayers pay no more than is necessary to ensure the continued adequacy of the company's service and provide a return to the shareholders that is reasonable under the circumstances. The Commission in its opinion recognized that, "in the final analysis, the matter of fixing just and

reasonable rates involves a balancing of the investor and the consumer interests"; and we do not doubt its purpose to find that balance. Our difficulty, as we have said, arises from the Commission's failure to provide us an adequate basis for knowing why it did what it did.

We thus have no intelligible basis for disposing of the competing claims before us that the return allowed by the Commission is, on the one hand, too high, and, on the other, too low. We remand the case to the Commission for further proceedings consistent herewith to determine the margin of return over and above operating expenses that Transit should be allowed.

It is so ordered.

WRIGHT, *Circuit Judge, concurring*: Whatever system of rate making is used in determining a proper bus fare, two basic questions must be answered: (1) How much money have the owners of D. C. Transit invested in the company, and (2) what has been and what is the return on that investment. Until the Commission answers these two questions in words of one syllable so the public, and the court, can understand, the suspicion of unconscionable profits at public expense will persist. The present bus fare is very close to the highest charged in the country. Until the public knows how much the owners of D. C. Transit are making, and have made, on their investment, the bus riders ought not to be required to pay more.

The Government states in its brief:

> "• • • From 1957 through the first eight months of 1962 (for which year the figures were annualized), the Company averaged a 60 percent return on average book equity per year, a figure far in excess of the 23 percent which the PUC found 'to be more than sufficient to compensate investors for the use of their

funds.' The return for the individual years are (P. 11):

"1957	84.3
1958	58.8
1959	141.1
1960	28.3
1961	29.1
1962 (8 months annualized)	16.5

"Of interest for comparative purposes is the return on book equity made by D. C. Transit's predecessor, Capital Transit Co. (P. 11):

"1952	4.4%
1953	4.3%
1954	3.0%"

In view of this statement by the Government, the Commission in its opinion on remand should set out, year by year, beginning with 1956, the amount of capital actually invested by the owners[1] of D. C. Transit, followed by the earnings, year by year, on that investment. Thus the court, and the public, will know whether the owners of D. C. Transit have been, and will be, fairly compensated for their investment.

I am not suggesting that the line of inquiries indicated by the court is not necessary in determining a proper bus fare. Of course, it is. I am saying that the primary inquiry is: How much are the owners of D. C. Transit really making on the money actually invested in the company. The public is entitled to the answer to this question—in plain English.

WILBUR K. MILLER, *Senior Circuit Judge*, dissents.

---

[1] Of course, if any capital has been returned to the owners, in any way, the year and amount thereof also should be disclosed.

SUPREME COURT, U. S.

FILED

JAN 21 1969

JOHN F. DAVIS, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1968

No. 783

D.C. TRANSIT SYSTEM, INC., *Petitioner*

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB AND WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT COMMISSION

RUSSELL W. CUNNINGHAM
General Counsel
Washington Metropolitan Area
Transit Commission
1815 North Fort Myer Drive
Arlington, Virginia 22209
Attorney for Respondent

Washington, D. C. · THIEL PRESS · 202 · 393-0625

CONTENTS

Commission Position 2

Statement 2

Discussion 2

I. Rate-Making Formula 3

II. Court Substituted Itself for Commission 4

III. The Case Should Have Been Remanded for Further Findings and Conclusions 6

IV. The Court of Appeals' Review Jurisdiction Is Not Restricted by Section 6 of the Compact to Only Rates of Return in Excess of 6½% 7

Conclusion 10

TABLE OF AUTHORITIES

CASES CITED:

Area Rate Proceeding for Permian Basin, 88 S. Ct. 1344 (1968) 5, 8

D.C. Transit System v. WMATC, 121 U.S. App. D.C. 375, 350 F.2d 753 (1965) 8

Federal Power Commission v. Hope Nat. Gas Co., 320 U.S. 591 (1944) 5

Payne, et al. v. WMATC, D.C. Cir. No. 20,988 (1968) 4, 6

Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951) 4

Universal Interpretive Shuttle Corp. v. WMATC, 89 S. Ct. 354 (1968) 2, 7

Williams, et al. v. WMATC, D.C. Cir. No. 20,200 (1968) ... 4, 5, 6

STATUTES CITED:

Transit's Congressional Franchise, Public Law 84-757, 70 Stat. 598 (1956)
Section 4 . . . . . 7, 8

Washington Metropolitan Area Transit Regulation Compact, Public Law 86-794, 74 Stat. 1031 (1960); 1 D.C. Code § 1410 (1961 ed.), Title II, Article XII
Section 6 . . . . . 7, 8
Section 17(a) 6

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1968

No. 783

D.C. TRANSIT SYSTEM, INC., *Petitioner*

v.

RICHARD A. WILLIAMS, ALFRED S. TRASK, DEMOCRATIC CENTRAL COMMITTEE OF THE DISTRICT OF COLUMBIA, LEONARD N. BEBCHICK, DANIEL W. GOTTLIEB AND WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT COMMISSION

D.C. Transit System, Inc. (Transit) has filed a petition for a Writ of Certiorari to the U. S. Court of Appeals for the District of Columbia Circuit to review the judgment of that court reversing two fare increase orders of the Respondent, Washington Metropolitan Area Transit Commission (Commission).

COMMISSION POSITION

The Commission has not itself sought review by Writ of Certiorari of the Court of Appeals' decision here in question because it does not believe that the questions involved are of sufficient importance to warrant review by the Supreme Court. See, *e.g.*, dissent in *Universal Interpretive Shuttle Corp. v. Washington Metropolitan Area Transit Commission*, 89 S. Ct. 354 (1968). Since D. C. Transit has brought the matter before the Court, however, the Commission believes it appropriate to indicate its views on the issues raised by the Petition.

STATEMENT

While the court's judgment touched many issues decided by the Commission in those two cases, Transit's petition raises only four substantive questions of error: first, that the court substituted a cost of capital formula in lieu of the operating ratio formula required by statute; second, that the court substituted its own findings in regard to the reasonableness of the permissible rate of return for those of the Commission; third, that the case should have been remanded to the Commission to enable it to develop additional evidence and/or make further findings; and fourth, that the court is precluded by law from disturbing a Commission order which authorizes a rate of return of less than 6½%.

The Commission concurs in the statement of the case recited in the Petition at pp. 3-8.

DISCUSSION

Our introductory remarks have emphasized that the Commission's role in this brief is neither to support nor oppose any of Transit's allegations, but to merely set forth the Commission's views on the salient issues raised by the petition. Hence, our remarks will be addressed to the issues outlined above.

I

Rate-Making Formula

Transit first argues that the Court of Appeals did not apply the operating ratio method of rate-making in its decision reversing the Commission. This failure, says Transit, creates a deviation in the law of sufficient importance to engage the attention of the Supreme Court. In the Commission's view, this is a misconstruction of the Court of Appeals' decision. The Court of Appeals' discussion of rate of return was not a substitution of the "cost of Capital" approach for the operating ratio approach. Rather, the court was spelling out some of the issues which should be taken into account in determining the proper level at which to set the return on gross operating revenues. Under the operating ratio method, the Commission must determine what operating expenses the company will incur in providing service. It must then set rates which will produce revenues sufficient to cover those operating expenses plus some margin over and above that amount. That margin, said the Court of Appeals, should not be determined in some abstract, unspecific manner. Rather, it should take into account an inquiry into such subjects as capital costs, capital programs, capital structure, and related subjects. Specifically, the court said:

> "We observed that the margin of return properly allowable over legitimate operating expenses is 'the sum of money needed to attract the capital, both debt and equity, required to insure financial stability and the resulting capacity of the utility to render the service upon which the public depends.' And we stressed the necessity for
>
> > 'inquiries and findings—judgmental as the latter may often be because ratemakers must be prophets of the future as well as historians of the past—into such things as the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio

> of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and the related matters which must be prayerfully explored by the conscientious regulator before he can begin to say why he fixed upon 4.87 rather than 6.5 or 3.2.'" *Williams, et al. v. WMATC*, D.C. Cir. No. 20,200, slip op. at pp. 6-7.

This was not a directive to substitute a cost of capital standard for the operating ratio method. It was merely an indication of the subjects into which the court thought inquiry was appropriate in setting a margin of return on the operating ratio theory of rate-making.

The Commission has, in subsequent cases, applied this approach to the operating ratio method and its decision has, in one instance, already been upheld by the Court of Appeals. *Payne, et al. v. WMATC*, D.C. Cir. No. 20,988, Oct. 8, 1968 (*aff'm* Order No. 684 [unreported], WMATC March 13, 1967).

Since the Commission does not agree that the Court of Appeals has rejected the operating ratio approach, but has merely explained the way in which it should be applied, it cannot agree with the arguments urged by Transit in Section I of its Petition.

II

Court Substituted Itself for Commission

The Commission is constrained to agree with Transit that the Court of Appeals improperly substituted its judgment for that of the Commission as to the permissible rate of return. It is a matter of established law that in reviewing Commission decisions, the court's function is to determine whether the Commission's action has a rational basis and is supported by substantial evidence. *Universal Camera Corp. v. NLRB*, 340 U.S. 474 (1951). The action of the Court of

Appeals went far beyond that standard. The Court of Appeals' decision itself indicates that there was ample evidence underlying the Commission's determinations. See the court's elaborate discussion of the testimony of expert witnesses in Order No. 563 and in Order No. 564, at pp. 6-25 and pp. 83-95, respectively, in *Williams v. WMATC, supra.* A reading of that decision can lead only to the conclusion that evidence supporting the Commission's conclusions was not lacking. Rather, we can only conclude that the court felt that it would have decided the case differently. We must agree with Transit's position that this is an improper exercise of the court's review function.

Moreover, in practical terms the court has chosen to reverse the Commission on an issue which has little actual impact on the result. The court determined that an appropriate return was *$1,107,000* while the Commission would have allowed *$1,480,000.* The difference between the two is *$373,000.* However, the total revenues required to be produced through the rate structure amounted to *$30,420,638.* A difference of *$373,000* or 1.2% of gross revenues would have had very little impact upon the fare levels required.[1] "This court has . . . repeatedly stated that the Commission's orders may not be overturned if they produce 'no arbitrary results.' *Federal Power Commission v. Natural Gas Pipeline Co.,* 315 U.S. 575, at 586 (1942); *Federal Power Commission v. Hope Nat. Gas Co.,* 320 U.S. 591, at 602 (1944)." *Re Area Rate Proceeding for Permian Basin,* 88 S. Ct. 1344, at 1372 (1968). To reverse the Commission in these circumstances, with the complex effects of that reversal outlined in the court decision, is not, in the Commission's view, consistent with the proper exercise of the judicial review function.

---

[1]The Commission authorized a change in the token rate only. Thus, the existing fare of tokens was 5 for $1.00 or 20¢ each. The new fare was 4 for 85¢ or 21¼¢ each. Therefore, the difference between the fare authorized and the fare necessary to produce the return the court would allow is approximately one half cent per token.

III

The Case Should Have Been Remanded for Further Findings and Conclusions

The Court of Appeals set aside the orders because the Commission did not make the "investigations and the resolutions essential to a legitimate exercise of its authority to prescribe just and reasonable fares." *Williams v. WMATC, supra,* slip op. at p. 27. Yet, it acknowledged that it did "not decide that the fares are unjust or unreasonable as a matter of law." Slip op. at p. 33.

This is precisely the posture of the Court of Appeals when it found Order No. 245 to be deficient. However in that instance, it remanded the case to the Commission for further findings. Consistency alone would seem to require corresponding treatment here. Moreover, this was not a case of a recalcitrant agency refusing to adhere to the jurisdiction of the court, for it explicitly rejected and disavowed any such motives. In fact, the Court of Appeals gave its approval to the Commission's rate of return treatment in a subsequent case. *Payne v. WMATC, supra,* D.C. Cir. No. 20,988.

While the Court of Appeals stressed that remand for agency determination of the proper rate of return could not be permitted because the Commission lacked jurisdiction to set fares for the past, its disposition of the case balances completely on the lower rate of return it accepted as the foundation for calculations to determine whether Transit had received excess profits.

If "investigations and resolutions" were lacking, the court should have followed the statutory language by remanding and instructing the Commission to take "additional evidence" and have the Commission "modify its findings as to the facts by reason of the additional evidence so taken. . . ." Article XII, Section 17(a) ("Judicial Review"), Compact.

In essence, its disclaimers to the contrary notwithstanding, the Court of Appeals did make "an independent determina-

tion" of the rate of return to be allowed Transit. This was error, for that is not its function. If the rate of return had to be re-determined, and it did under the court's disposition, then the court should not have engaged independently in such an exercise, but should have returned the case for the Commission to make that investigation and resolution.

IV

The Court of Appeals' Review Jurisdiction Is Not Restricted by Section 6 of the Compact to Only Rates of Return in Excess of 6½%

Transit's contention that Section 4[2] of its Franchise and Section 6[3] of the Compact prohibit the Court from disturbing any agency order permitting a rate of return of less than 6½% is clearly not in accord with the language of those provisions.

Transit correctly has pointed out that Section 6 of the Compact is merely a reaffirmation of Section 4 of the Franchise. The language is virtually identical and the legislative history of the Compact clearly indicates that its draftsmen intended to carry the import of Section 4 of the Franchise forward into the Compact.

Transit's contention rests primarily upon a dictum in the opinion of this Court in *Universal Interpretive Shuttle Corporation v. WMATC, supra,* at p. 357. There, in comparing the statutory powers of the Secretary of the Interior and of the Commission, this Court noted that the Commission would have the power to suspend any fare of a carrier subject to its jurisdiction and that it could set whatever fare it found reasonable. Following this declaration, this Court then stated that nevertheless, "a profit of 6½% could not be prohibited."

---

[2]Pub. L. 84-757, Tit. I, pt. 1, c. 669, § 1(a), 70 Stat. 598 (1956).

[3]Pub. L. 86-794, 74 Stat. 103 (1960).

That dictum is imprecise, but even if it were not, it cannot be considered to be controlling. The construction of Section 6 of the Compact was not even obliquely at issue in *Universal*. "This court does not decide important questions of law by cursory dicta concerned in unrelated cases." *Re Area Rate Proceeding for Permian Basin, supra,* 88 S. Ct. at 1364. Nevertheless, Transit has seized upon this dictum to insert a new issue in this case at this late date.

The striking facet about Transit's contention is that the prohibition would run against a reviewing court, but not against the Commission. It must be remembered that it is the Commission's function to establish a rate of return, not that of a reviewing court. It is the function of the latter merely to determine whether the rate of return found by the Commission to be proper is legally sound and resting upon substantial evidence. Transit makes no claim here that the Commission could not properly set a rate of return at less than 6½%. Its argument assumes only that a reviewing court cannot disturb any order of the Commission permitting a return of less than 6½%. Thus, review of this important element of a rate case would be precluded unless the Commission authorized a rate of return which would exceed 6½%. This is indeed a strange construction of a statutory provision which is designed primarily as a guideline for the Commission—not a reviewing court.

Finally, in a decision not appealed by Transit, the Court of Appeals three years ago specifically found that the 6½% proviso was not a "floor" or guarantee. *D.C. Transit System v. WMATC,* 121 U.S. App. D.C. 375, 350 F.2d 753 (1965). After a thorough analysis of the statutory language and the underlying legislative history, the Court of Appeals concluded that neither Section 4 of the Franchise nor Section 6 of the Compact guarantees Transit a minimum of 6½% on Transit's gross operating revenues. The court's reasoning is persuasive:

> "The Commission, by virtue of Section 6(a)(3) of the Compact, is obligated to set for the carriers over

> which it has jurisdiction 'just and reasonable fares'—a standard which has invariably imposed an obligation to balance the interests of both the utility and the consumers. In this setting, the deceptively specific language of Section 4 and Section 6(a)(4) should not be read as depriving the Commission of that discretion which is a customary, and necessary, element of rate-making. We think Congress used the figure of 6.5 per cent simply to suggest a general objective of this regulatory scheme—to allow Transit a higher return than its predecessor had received. It clearly seems to have intended that the rate-making authority should look to other criteria as well. Certainly this was the understanding, and the practice, of the PUC, as it was, in this case, of the Washington Metropolitan Area Transit Commission. The former consistently took the position that it possessed authority to set Transit's rates at whatever level it found to be 'just and reasonable'—high enough to insure that the company's capital requirements would be met, and low enough to enable it to continue to attract and retain patrons. On three different occasions the Commission found this level to be below what Transit now claims is the statutory minimum. Both the PUC's position and its performance were matters of public record, and well known to Congress, when the Compact was enacted with the purpose of continuing the rate-making formula already in use. Congress was similarly and explicitly aware of the PUC's interpretation when it adopted the school fare subsidy provision in 1962, but only after deleting the reference to a specific rate of return. We find this history compelling evidence of how Congress intended the rate provisions of the Franchise Act and the Compact were to operate." [Footnotes omitted.]

Of course, in that case, Transit was contesting the power of the Commission to establish a return below 6½%, as contra-distinguished from its argument here that the Court of Appeals is precluded from disturbing any return of less

than 6½%. Nothing in the statutes confers so rigid a constriction upon the review power of the Court of Appeals.

CONCLUSION

While the Commission has disclaimed any intent to seek review of the opinion of the Court of Appeals, it believes that that opinion was correct in its application of the operating ratio formula and that the court does have review powers over orders of the Commission allowing rates of return of less than 6½%. On the other hand, the Commission concurs with Transit that the Court of Appeals improperly assumed functions of the Commission and erred procedurally by failing to remand the case for further rate of return determinations by the Commission.

Respectfully submitted,

RUSSELL W. CUNNINGHAM
General Counsel
Washington Metropolitan Area
Transit Commission
1815 North Fort Myer Drive
Arlington, Virginia 22209
Attorney for Respondent

January 21, 1969